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CONCENTRATION OF MARKET POWER, THROUGH MERGERS, TAKE-OVERS, JOINT VENTURES AND OTHER ACQUISITIONS OF CONTROL, AND ITS EFFECTS ON INTERNATIONAL MARKETS, IN PARTICULAR THE MARKETS OF DEVELOPING COUNTRIES

Report by the UNCTAD secretariat

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SUMMARY AND CONCLUSIONS

A. Trends

(i) There has been a massive increase in mergers in developed countries during the 1980s. Although it has undergone a relative decline in the United States and the United Kingdom during the last two years, merger activity looks like to continue at a high rate in the 1990s. Joint ventures, particularly new types of "strategic alliances", have also greatly increased. In contrast with mergers, which have occurred in all industry sectors, these joint ventures have been formed mainly in high-technology sectors. There has also been an increase in the practice of cross-shareholdings among companies. The growth in these different types of acquisitions of control has been influenced, *inter alia*, by: the globalization of markets, the greater intensity of competition, the speed of technological change, low growth in some industries, regional integration processes, and the liberalization of competition law that has taken place in several developed countries.

(ii) Merger activity in developing countries has been relatively small, but the growth rate has been significant, particularly in Latin America (often in the context of debt-equity swaps) and, to a lesser extent, in the Far Eastern region. The structural characteristics of the industries, capital markets and firm organization in most developing countries have impeded mergers, but an evolution is taking place. Firms from the Far East have also become more active as buyers in the merger markets of developed countries. Joint ventures between firms from developed and developing countries are far more common than mergers, although they are not usually of the "strategic alliance" type. Privatization has also taken place on a large scale in many countries, although in some developing countries, difficulties experienced have reduced the rate of privatization.

B. Arrangements involving locally established firms

(iii) Mergers and joint ventures among locally established firms are likely to have a strong impact on the markets of developing countries because these are usually highly concentrated. Low demand in these markets can sustain relatively few firms producing on a minimum economic scale, while other obstacles to new market entry include limited availability of entrepreneurship and production inputs, inefficient distribution and communications systems, poor information flows, and regulatory barriers. This would suggest a need for greater vigilance to ensure that horizontal arrangements do not eliminate competitors, that vertical arrangements do not foreclose production inputs or distribution channels, or that conglomerate mergers do not lead to the control of small economies resting in a few hands.

(iv) However, account would also need to be taken of factors reducing the market power of merging firms. It would also be necessary to be alive to the possibilities for mergers and joint ventures to reduce market concentration by allowing new market entry or better competition against market dominant firms. Moreover, mergers and joint ventures can lead to greater efficiencies in relation to investment, management, production, sales or technological innovation, while positive spin-off effects can also occur within the industrial sector, among suppliers or within the whole economy. It is also true, however, that mergers and joint ventures often lead to inefficiencies, while reducing the healthy stimulus to efficiency provided by

competitive markets. In view of all these factors, it is impossible to generalize about the effects of mergers and joint ventures in the domestic markets of developing countries, and a case-by-case analysis is necessary.

(v) In many cases, competition from imports would diminish concerns about anti-competitive effects of acquisitions of control by providing market discipline against any such effects and because acquisitions could improve the competitiveness of developing countries' firms against such imports. However, foreign competition is not a perfect substitute for local competition, especially in developing country markets, because of a number of entry barriers and other factors, because many products and services are inherently local in character, and because of discriminatory price policies of TNCs.

(vi) Moreover, premature exposure of developing country firms to "imported competition" may, by decimating infant industries, lead to concentration of market power in foreign exporters or trading intermediaries, taking into account that a relatively small number of large firms undertake the bulk of exports from some countries, that only some of these firms would be exporting to individual developing countries, that high concentration also exists among the trading intermediaries in the import channels of some developing countries (particularly in respect of some agricultural commodities) and that some exports from developed countries are controlled by export joint ventures or cartels (although these appear at present to control only a small proportion of such exports).

C. Arrangements between locally established firms and new TNC entrants

(vii) A merger or joint venture between a locally established firm and a TNC entering *de novo* into a developing country would not affect concentration unless production was for the domestic market and the TNC had previously been competing through imports with the firm taken over, or unless the new entry would lead to premature exposure of other firms to the superior competitive ability of the TNC; the replacement of a local oligopoly by a foreign-controlled oligopoly would not benefit competition.

(viii) On the other hand, the new entry may be beneficial by providing a healthy competitive stimulus to concentrated markets. Whether this in fact happens would depend upon the extent to which market segmentation occurs; in many cases, TNCs established in developing countries focus upon market segments where quality and price are higher, and leave the other segments of the market for local firms. But in any event, a take-over of a local firm by a TNC can lead to many efficiencies, notably through the transfer of "firm-specific assets" such as managerial skills, technology, brand names or marketing networks and know-how. Inefficiencies can also arise, particularly where the TNC has minimal links with the local economy or with local suppliers, where there is market foreclosure for potential exports from the local subsidiary, or where transfer pricing abuses occur. So a case-by-case analysis would again be necessary to determine the effects upon market concentration and efficiency of take-overs of local firms by incoming TNCs.

D. Arrangements occurring overseas

(ix) Some mergers and joint ventures occurring in developed countries, even where they have not had anti-competitive effects in the home countries of the firms involved, have affected developing country markets through restrictions on the freedom of affiliated firms to compete. They have also heightened possibilities for collusive arrangements and international cartelization in a number of industries (including industries where the bulk of production is by TNCs which are meeting each other across national frontiers), although such possibilities have yet to be fully realized. In addition to such industries, overseas mergers would partic-

ularly effect developing countries where they occur among trading intermediaries; in some agricultural commodity sectors such as processed tea, coffee or cocoa; in some service sectors; and in high-technology areas such as the biotechnology, computer or semi-conductor industries. Although competition does take place among oligopolists in these product markets, it does not necessarily extend to all geographical markets.

(x) However, overseas mergers and joint ventures have also resulted in positive effects for developing countries. They have helped some foreign firms to compete better against other market-dominant firms trading with developing countries, as well as leading to increased investment in individual developing countries. Countries which are host to TNCs may thus be better off when the TNCs merge than countries which are only trading with them, as they could either benefit in investment terms or take competition law measures to minimize any anti-competitive effects upon their markets. Other action that could be taken against anti-competitive effects includes joint buying pools (in cooperation with other countries where necessary) to countervail the market power of foreign exporters; more take-overs by developing country firms of SMEs in developed countries; promotion of trading contacts and joint ventures with such SMEs and with firms from other developing and Eastern European countries; and the participation of more developing country firms within the networks of mergers and "strategic alliances" among developed country firms. An integrated approach to such options would be the most effective.

E. Policies and cooperation

(xi) An integrated approach is also necessary in respect of all government policies directly or indirectly affecting competition in general and acquisitions of control in particular, including policies towards foreign trade, foreign investment, industry and structural adjustment, deregulation, privatization, consumer protection and financial market and firm structures. There is also a need for consistency and coherence between such policies and competition law. This need is particularly important in respect of trade policy, where the benefits of international trade liberalization may be reduced by the anti-competitive conduct of foreign firms, or where VERs can lead to anti-competitive consequences in both importing and exporting countries; in industrial policy, which can promote either large firms or SMEs; and in deregulation and privatization policies, where it would be necessary to ensure that firms do not take advantage of the vacuum left by Governments' retreat to undertake anti-competitive action.

(xii) There is also a need, in order to avoid unnecessary distortion of business decisions, to ensure consistency and a degree of neutrality in the application of competition law towards different types of RBPs, existing monopolies, mergers, different types of joint ventures, and interlocking shareholdings and directorates, taking into account differences in their effects. The present study has mainly concentrated upon the effects of mergers. Further in-depth study of the relationships of competition with trade and with deregulation, as well as of competition law treatment of privatization and of different types of joint ventures and interlocks, would be necessary to clearly delineate the relevant issues and make appropriate recommendations.

(xiii) Among developed countries, the two basic trends in merger policies in the 1980s have been widespread adoption of merger control laws by countries having no such laws, and substantial liberalization of controls in countries already having laws. Such liberalization has occurred through greater account being taken of existing or potential competition from imports, the promotion of competitiveness of local firms in international markets, the effects of regional integration, a number of factors which would reduce market power arising from mergers, and efficiency considerations. There are some differences in the weight attached to such factors among developed countries, but the similarities in the analyses applied are more important.

(xiv) The overseas effects of domestic acquisitions of control are generally only dealt with to the extent that there is "spillover" onto the domestic market. The internationalization of

production is likely to lead to such "spillover" happening increasingly often. Steps that could be taken by developed countries to minimize the effects abroad of behaviour by local firms, particularly export joint ventures and cartels, include, *inter alia*, avoiding encouraging such cartels, requiring notification to themselves of the formation and existence of such cartels, and cooperating with investigations by competition authorities of developing countries. The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, which provides that appropriate action should be taken to eliminate restrictive business practices adversely affecting international trade, particularly that of developing countries, and development, would be an appropriate instrument for such cooperation.

(xv) The domestic effects of overseas acquisitions of control have been of recurrent concern in developed countries, though more in connection with joint ventures or cartels than with mergers. Some countries have sought to apply their laws only within their territories, while a few, in reliance upon the "effects doctrine", have attempted to assert substantive or procedural jurisdiction over conduct occurring overseas, giving rise to jurisdictional conflicts. More and more mergers require approval by several competition authorities, leading to inconsistent substantive results and procedural problems, particularly in respect of pre-notification requirements.

(xvi) In a world where markets have become increasingly interdependent, where enterprise transactions increasingly cross national borders, and where more competition laws are being adopted, *inter alia* by a growing number of developing and Eastern European countries, it is clear that this will happen more and more often, decreasing enterprise security and leading to possible conflicts among different competition systems. Although the application of the comity principle in the enforcement of national law may reduce conflicts, it cannot provide a fully satisfactory solution. A number of bilateral and plurilateral agreements among developed countries testify to serious attempts being made to strengthen cooperation to avoid conflicts. However, only the notification and consultation parts of these agreements have been properly used so far. A number of approaches are being suggested to take things further, such as increased information sharing; improved mechanisms for obtaining information from private parties in foreign countries; the harmonization of information requirements, or substantive law and enforcement policy; allocation of jurisdiction of mergers in accordance with the relative interests of countries and assets within their territories; and even an international merger control regime. Indeed, it has been urged that harmonization is all the more necessary because of the risk that world monopolies or oligopolies will distort international competition. Developing countries may wish to join the ongoing debate and search for appropriate solutions, using the consultation machinery provided in the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices (the Set).

(xvii) For developing countries to be able to participate in such a search, however, it would be essential for them to adopt and apply competition laws in general and merger control laws in particular, as well as to ensure that such laws are up-to-date and in tune with both the specific competitive conditions in developing country markets and the current world environment. A number of developing countries have adopted and are applying merger control laws, with a certain degree of success. Efficiency and competitiveness considerations are taken into account in some of these laws. But problems are being experienced *inter alia* in connection with the lack of clear policy guidelines as to the appropriate balance between competition and efficiency, lack of public, business or judicial awareness of what competition entails, lack of necessary data and trained staff, and lack of adequate enforcement machinery. Clearly, great efforts are necessary to enable States without merger control legislation, or even a competition law, to adopt such legislation, to enable States having such legislation to effectively apply it and/or to undertake the necessary pedagogical efforts to raise consciousness of competition issues at the national level, and to enable States to overhaul and modernize their legislation. Without such an effort, it would not be possible to deal effectively with restrictive business practices adversely affecting trade and development. Cooperation from other countries would assist developing countries in such endeavours.

F. Possible policy measures

(xviii) In the light of the above, possible policy action by States could include:

(a) The full implementation of all provisions of the Set of Principles and Rules, in order to ensure its effective application;

(b) The adoption, improvement and effective enforcement of appropriate competition legislation and procedures;

(c) Technical cooperation to assist such endeavours;

(d) Improved transparency, information sharing, consultations and cooperation among Governments in respect of arrangements affecting competition, particularly acquistions of control having effects overseas; and

(e) Further consideration of the interrelationships between competition and trade policies, and between competition policy and deregulation, as well as of competition law treatment of different types of joint ventures, interlocking shareholdings/directorates, and privatization.

INTRODUCTION

1. The present study has been prepared in accordance with the agreed decisions and conclusions adopted by the Intergovernmental Group of Experts on Restrictive Business Practices an its sixth session,[1] and follows through from previous progress reports on this subject prepared by the UNCTAD secretariat.[2] As provided for in the mandate, this study deals with the effects on the domestic and export markets of developing countries of concentration of market power occurring through horizontal, vertical or conglomerate acquisitions of control. The types of acquisitions of control that are covered include mergers and take-overs (through transfers of shares or of assets, including debt-equity swaps[3] and management buy-outs[4]), interlocking directorates or shareholdings (interlocks), joint ventures,[5] and privatization.[6] Thus, an acquisition of control need not necessarily involve a partial or complete change in the legal ownership of an enterprise, but concerns rather a change relating to the *de facto* control of the enterprise concerned (although joint ventures would in most cases involve the creation of a new entity or other collaboration by two or more enterprises). In practice, of course, it may often be difficult to draw the line between control over an enterprise and influence over its conduct. The main emphasis of the study will be upon mergers and take-overs (the two terms will be used interchangeably) and, to a lesser extent, upon joint ventures.

2. The parties to acquisitions of control having effects upon the markets of developing countries can be all locally established, involve one locally established and one foreign party (e.g. the take-over of a local enterprise by a transnational corporation (TNC) or the take-over by a local enterprise of a foreign company), or be all foreign-owned (e.g. overseas mergers of TNCs involved in trading or competing with developing country enterprises).

3. The study is divided into six chapters and an annex. Chapter I assesses what has happened (i.e. recent trends relating to different types of acquisitions of control), why it has happened, and the structural context in which it has occurred. In the light of these, the chapter then attempts to predict future trends. Chapter II describes some competitive conditions in the domestic and export markets and trade channels of developing countries which are relevant to an analysis of the effects thereon of acquisitions of control. Chapter III describes the beneficial and adverse effects upon both concentration of market power and efficiency of acquisitions of control among locally established firms in developing countries. Chapter IV looks at the effects of acquisitions of locally established firms by TNCs not previously established in the country. Chapter V looks at the effects of acquisitions occurring overseas. Chapter VI describes the relevant legal and policy framework in developed and developing countries, including both those policies having a general effect, and specific competition rules dealing with mergers. The annex to this study reviews relevant experiences of the Republic of Korea in this field.

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1 The Secretary General of UNCTAD is thereby requested to prepare a *"study on the subject of the concentration of market power through mergers, take-overs, joint ventures and other acquisitions of control, whether of a horizontal, vertical or conglomerate nature, and its effects on international markets, in particular the markets of developing countries"*. See "Report of the Intergovernmental Group of Experts on Restrictive Business Practices on its sixth session" (TD/B/1156-TD/B/RBP/43).

2 See the two papers entitled "Activities relating to specific provisions of the Set of Principles and Rules" (TD/B/RBP/48 and TD/B/RBP/60).

3 The conversion of a debt instrument of a debtor country into an equity investment within that country. Typically, once an investment proposal has been approved by the competent authorities, the investor purchases the foreign currency debt at less than face value, converts it to local currency and proceeds to make the approved investment.

4 A transfer of company ownership where the existing employees are a significant element in the new set of owners. For the purposes of this paper, no distinction is made between buy-outs by a management team or by all the employees ("employee buy-outs").

5 For the purposes of this study, a broad definition of joint ventures has been adopted to include any arrangement "in which the operations of two or more firms are partially, but not fully, functionally integrated". See *Competition Policy and Joint Ventures*, OECD, Paris, 1986. The existence of equity stakes would thus not be necessary, so that contractual ventures and "strategic alliances" would be covered, although *ad hoc* agreements would be excluded. The acquisition of shares in an existing firm by at least two other firms would also be covered; this could also be considered to be a merger.

6 The main emphasis of this study is upon privatizations occurring through partial or complete transfer of ownership from the public to the private sector (i.e. divestiture), rather than other arrangements not involving transfer of ownership control.

Chapter I

TRENDS, MOTIVATIONS AND STRUCTURES FOR ACQUISITIONS OF CONTROL

A. Trends in acquisitions of control

1. Mergers

4. The 1980s, particularly in the latter half, saw a massive increase in acquisitions of control. Particularly striking has been the merger activity in developed countries, which included a large number of management buy-outs in the United Kingdom and the United States. Transactions involving United States companies are estimated to have totaled over $1.3 trillion during the decade.[7] Within the EEC, merger activity in the United Kingdom increased threefold between 1985 and 1988 to reach 57 billion ECUs, and in France sevenfold during the same period to reach 26.5 billion ECUs.[8] Merger activity in Japan, while relatively limited, has steadily increased, although contested bids are very rare. As compared with previous merger waves, distinctive features of mergers in the 1980s were their often very large value and cross-border character, and their predominantly horizontal nature (conglomerates have in fact been busily divesting during this period). The often contested nature of take-over bids, and the use of restructuring vehicles such as leveraged buy-outs, management buy-outs and junk bonds, particularly in the United States, have also been striking features of the merger wave. Merger activity has been prevalent in nearly every sector, some of the most affected including the food and food retailing, white goods, packaging, chemical/pharmaceutical, petroleum, paper, automobile and parts, telecommunications, airline, electromechanical, financial services, hotel, publishing and advertising industries.

5. However, mergers in the United States are reported to have fallen from $US 257 to $174.5 billion from 1989 to 1990,[9] with a particularly sharp decline in leveraged buy-outs and (to a lesser extent) in contested bids in general. A similar decline has occurred in the United Kingdom. But merger activity has so far continued unabated in the European Community as a whole, where the number of mergers and acquisitions of majority stakes between 1988/89 and 1989/90 (July to June) increased from 666 to 833,[10] although the relative share of mergers with a combined participants' turnover of over 10 billion ECUs has declined sharply relative to the total number of mergers.

6. It is difficult to fully assess the extent of merger activity involving firms based in developing countries, given the lack of available data. However, it is reported that their involvement has so far been relatively small (particularly in value terms), but that the growth rate of such activity has been significant in the case of enterprises from Latin America[11] and from the Far Eastern

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7 See S. Waite, "All the World's a Stage for M & A in the 1990s", *Mergers and Acquisitions*, September/October 1990, p.82.

8 See Booz Allen Acquisition Services' "Study on Obstacles to Takeover Bids in the European Community", prepared for the European Commission, p.13.

9 See "It all looks so different", Corporate Finance Survey, *Financial Times*, 28 June 1991.

10 Comparison of recent data furnished by the Commission of the European Communities, with its "Nineteenth Report on Competition Policy", 1990.

11 See *Profits under pressure in Latin America*, Business International Corporation, New York, 1985.

region.[12] Some domestic merger activity has occurred in Hong Kong, Malaysia and Singapore, including a few take-overs of local companies by companies from developed market-economy countries. There are also data indicating that there has been significant merger activity in these countries amongst TNC subsidiaires in the advertising and accounting sectors (following overseas mergers of parent companies[13]), and this may well have also been the case in other sectors. In the Republic of Korea, there has been substantial merger activity, as described in the annex. A few mergers have also occurred in India, in sectors such as the food-processing industry.

7. In recent years, firms based in the Far East have also become more active as buyers in the merger markets of developed countries. In 1989, for example, 16 take-overs in the United States were made by firms based in Hong Kong, four by firms based in Taiwan Province of China, four by Singaporean firms, and one by a Thai firm. In general, firms from the Far East have tended to concentrate take-overs in such sectors as informatics, biotechnology, petroleum, hotels, food and distribution, but take-overs have also been made in other sectors. Government-owned enterprises have also participated in such take-over activity. The largest take-over by firms from the Far East to date appears to have been the $268 million acquisition of a United States company which is a market leader in computer terminals, with an extensive distribution network, by a consortium of companies from Taiwan Province of China, with the participation of a government development fund.[14]

8. In contrast with the situation relating to enterprises from the Far East, the available data would indicate that there have only been isolated cases of take-overs abroad, by Latin American enterprises, mainly of United States-based enterprises; there have also been a few take-overs in Europe by Brazilian firms. Merger activity within Latin America has been far more significant. During the economic crisis that hit most Latin American countries in the 1980s, there appears to have been substantial divestiture by TNCs of their Latin American subsidiaries. These sales were either to local investors (sometimes through management buy-outs) or to other TNCs, although foreign investment régimes in some countries have been perceived as discouraging the latter. In cases of sales to local groups, divesting TNCs have often tended to maintain contacts with their former subsidiaries through minority shareholdings, licensing or technical assistance arrangements, or joint ventures. On the other hand, other TNCs have taken advantage of the "buyers' market" created by the economic situation to take over subsidiaries of other TNCs, the interests of joint venture partners or independent local firms. Take-overs have often been linked with debt-equity swaps, particularly in Brazil and Chile, since these countries have allowed swaps for private sector as well as public sector debt. Between 1986 and 1990, debt-equity swaps yielded debt reductions in Brazil and Chile in the order of $9.5 and $6.5 billion respectively. In Brazil, only foreign investors were allowed to take advantage of swaps, while in most countries local residents have also been eligible.[15]

9. In Africa, there have been cases of take-overs by TNCs of subsidiaries of other TNCs operating in Africa in such sectors as food processing, fertilizers and textiles (in Zimbabwe) or pharmaceuticals (in Senegal).[16] But there have also been instances of foreign firms acquiring shares or assets of local private companies, as in the transport sector in Zambia, or in the textile sector in Togo. Debt equity swaps involving private companies have been few, given the fact that most debt is owed to Governments, but some swaps have occurred in countries such as Zambia. There has been some merger activity in Kenya between both small local firms and larger subsidiaries of TNCs whose parents have merged (although, in the latter case, the recently established competition authorities have begun to block mergers).[17]

10. In some developing countries, gradual transfers of ownership of enterprises from foreigners to nationals, or between ethnic groups, have occurred as a result of "fade-out" or "indigenization"

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12 See "How Pacific Rim Buyers Are Hitting the World M & A Scene", *Mergers and Acquisitions*, Vol.25, No.1, July/August 1990, p.26.

13 See Sieh Lee Mei Ling, "Professional Business Services in ASEAN and the Uruguay Round Trade Negotiations", *Services in Asia and the Pacific: Selected Papers, Vol.1 (UNCTAD/ITP/51)*.

14 See "How Pacific Rim Buyers Are Hitting the World M & A Scene".

15 See UNCTC report, "Transnational banks and debt-equity conversions" (E/C.10/1991/5).

16 See Page S, and Riddell, R., "FDI in Africa: opportunities and impediments", *The CTC Reporter*, No.27 (Spring 1989).

17 Statement made by Kenyan delegation during the Second United Nations Conference to Review all Aspects of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices.

regulations. In Nigeria, for example, it is estimated that out of some 1,200 enterprises affected by the Nigerian Enterprises Promotion Decree 1977, 930 had been transferred to Nigerians by 1985.[18] In Malaysia, between 1971 and 1990, ownership of corporate wealth by foreigners was reduced from 63.3 to 25.1 per cent, while ownership by Bumiputras (indigenous Malays) was increased from 2.4 to 20.3 per cent.[19] However, the implementation of such legislation has since been liberalized in both countries, as has similar legislation in some other developing countries (at least in respect of transfers from foreigners).

2. Joint ventures

11. The 1980s have seen an increase in the use of joint ventures by enterprises of many countries from all regions. In developed countries there has been a particularly sharp increase in cross-border joint ventures, as well as in new types of "strategic alliances", especially with regard to research and development, and the introduction of new production methods. Some of the sectors where joint ventures have been prevalent include the informatics, electronics, robotics, telecommunications, aerospace, automobile and parts, and chemical/pharmaceutical sectors. In general, joint ventures have been formed more readily in high-technology areas, in contrast with mergers, which cut across all sectors. The nature of the ventures formed, and the closeness of collaboration, has varied greatly. In developed market-economy countries, it has also become increasingly common for companies to take minority stakes and/or cross shareholdings in each other in the context of technological or industrial cooperation or licensing arrangements. This practice is very prevalent among Japanese companies where there are numerous coalitions of interlinked companies (the most closely linked of which are called the "keiretsu"). A few United States companies are reported to be starting to follow this example by taking stakes in suppliers, customers and distributors.[20] The countries of Eastern Europe, China and some technologically advanced developing countries have seen sharp increases in numbers of joint ventures formed between local and foreign enterprises, although these have usually been of the traditional kind, rather than the new kinds of "strategic alliances". A large proportion of joint ventures in developing countries have been in such industries as electronics and electricity, fabricated metal, chemicals, automobiles and parts, industrial supplies, food, and machinery and tools. In many developing countries which are less technologically advanced, however, joint ventures have been confined to a few industries such as the pharmaceutical, agro-industrial or mining sectors.

3. Privatization

12. Privatization has taken place on a massive scale in a large number of countries over the last decade. The pioneer among developed countries was the United Kingdom where, by April 1989, proceeds from privatization totalled over £24 billion pounds sterling.[21] This example was rapidly followed by other developed countries. The countries of Eastern Europe are now starting off massive privatization programmes. Among developing countries, a few had already undertaken limited privatization during the 1970s, but major programmes by many countries only began to be implemented during the 1980s, resulting in the transfer to the private sector of a large number of enterprises in all sectors. A sample of 10 countries studied in a recent OECD report[22] had, for example, carried out more than 200 operations. Chile has, since 1985, privatized 38 enterprises for approximately $1 billion. Privatization has assumed a key policy role and has been incorporated

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18 See F. Beveridge, "Taking Control of Foreign Investment: A Case Study of Indigenization in Nigeria", *International and Comparative Law Quarterly*, Vol.40, April 1991, p.302, at p.317.

19 See "Mahathir offers new policy initiatives", *Financial Times*, 18 June 1991. In Malaysia, a Foreign Investment Committee regulates take-overs by both foreign and local companies, taking into account such factors as the extent of Malaysian (particularly Bumiputra) participation and a number of other socio-economic factors.

20 See "Why Japan Keeps on Winning", *Fortune*, 15 July 1991.

21 See "Privatization in the United Kingdom", Background Briefing, by Her Majesty's Treasury.

22 See, O. Bonin and Ch.-A. Michalet, *Rebalancing the Public and Private Sectors: Developing Country Experience*, OECD Development Centre, Paris, 1991.

in economic adjustment programmes of many countries, particularly in Latin America and Sub-Saharan Africa, often under the influence of international financial institutions. However, the difficult privatization process has been relatively slow, and many of the enterprises privatized have been among the smaller ones. Complete disposals of enterprises have been relatively rare, and many developing countries have realized little from privatization. Thus, a gap has opened between intentions and practice.

13. The techniques of divestiture through privatization have included public offerings, transfers of equity or assets (including through debt swaps), management buy-outs, and unsubscribed increases of capital (new methods are now being tried in Eastern Europe). Privatization techniques without divestiture have included leasing, management contracts, subcontracting, licensing, and franchising. Public offerings have been used much more in developed than in developing countries, where the favourite method of privatization has been through complete or partial sales of shares or assets to private purchasers. Debt-equity swaps have been used frequently in some countries, but tighter restrictions are now applied (a few countries have terminated their programmes).

14. The largest number of sales has been made to local firms, but the average value of such sales has often been very low, and the average value of sales to foreign investors far higher, in most developing countries. Larger-value sales, particularly those in the financial, transport and communications sectors, have in fact tended to depend upon foreign involvement or public share issues. The acquisition of foreign controlling stakes in key national industries through privatization has been a recurrent concern in countries from all regions, and innovative mechanisms such as limitations upon the percentage of shares that can be acquired by foreign investors, the placement of controlling stakes with trusted national firms (as in the French privatizations), or the maintenance by Governments of "golden shares" giving power to veto take-overs (as in the United Kingdom) have sometimes been used to maintain national control, as well as for other reasons. Some "strategic" sectors have usually been excluded from privatization in every country.

B. Motivations

1. Acquisitions of control of private firms

15. The impetus for a merger usually comes from the managers of the acquiring firm. Their motivations may be characterized as being either speculative, personal or investment-related. In considering investment-related mergers, a number of possible reasons may explain why the acquiring firm chooses to merge rather than to expand through internal growth. "Industrial" reasons may include the possibility of acquiring extra capacity faster, more easily, or for less cost than building a plant would entail, leading to a number of production efficiencies *(see paragraph 16 below)*. "Financial" motives may include the realization of pecuniary economies of scale, or reductions in transaction costs, as well as "external" benefits from tax advantages or government incentives. "Technological" motives may include the obtaining of access to the technology and production experience of the firm acquired, and the facilitation of R and D. Perhaps of most interest for competition law, market-related objectives may include both the realization of efficiencies in sales *(see paragraph 53 below)* and the acquisition of market power *(see paragraphs 41 to 46 below)*. A combination of all these motives would lead to a desire to acquire the assets of another firm in a "packaged" form.

16. Some of the above-mentioned motivations also explain the formation of joint ventures. Their limited and flexible nature, their lesser cost, risk-sharing possibilities and the multiplicity of the links possible may make them preferable for some enterprises. In many developing countries, foreign investors, especially smaller firms, may prefer joint ventures because of the risks associated with operating in an unfamiliar environment, the limited importance of individual markets, and the opportunity to take advantage of a local firm's market entry and knowledge advantages. Local firms in developing countries hope to gain by participating in projects which would otherwise re-

main beyond their reach financially or technologically, and by having the assistance of their foreign partners to export. The large numbers of mergers and joint ventures that have occurred during the 1980s were also certainly influenced by the prevailing economic and financial environment, and indeed form part of the larger phenomenon of the growth in foreign direct investment. The economic growth experienced in developed market-economy countries, the globalization of markets and of production, the greater intensity of competition, and the greater importance of "speed-to-market", services, product differentiation and quality have all played a role.

17. The speed of technological change has necessitated greater financial capacity, higher production volumes and sales, and speedy and extensive penetration of world markets so as to amortize costs and diversify risks. On the other hand, in declining or low-growth industries, strengthening market positions has necessitated the acquisition of existing assets (sometimes to get them off the market), in order to avoid the over-capacity that internal growth would entail. The presence of many willing sellers on the market, strong company profitability, the easy availability of finance, anomalous stock market valuations, favourable tax environments in a few countries, and liberalized regulatory controls on mergers and on foreign investment all provided appropriate opportunities. To a large extent, the growth in mergers and joint ventures has been self-perpetuating, since the activity of individual firms has stimulated their competitors to follow suit to avoid falling behind, while mergers have often been followed by subsequent divestments.

18. Many mergers or joint ventures within the European Community have been undertaken by a desire to be optimally placed to benefit from the Community's integration process, while foreign acquirers appear additionally to have been motivated by fears of protectionism. The influence of regional integration processes has also been evident in merger activity involving Canadian companies, and has influenced acquisitions by TNC subsidiaries in some Latin American countries,[23] although regional integration schemes by developing countries have not led to any large inflow of new foreign investment.

19. Data gathered by the European Commission[24] list the following as stated motives for mergers and joint ventures: the reinforcement of market position (by far the most important motive for mergers), expansion, complementarity, diversification, restructuring, R and D, cooperation, other and unspecified motives. Take-overs by foreign firms of local companies in the Far East have been mainly because they have assets otherwise difficult to obtain (e.g. holding companies), and perhaps because, in other cases, relatively high stock market valuations or expanding product markets may have made building plant more attractive, or because market entry conditions made joint ventures preferable (by contrast, as noted above, in Latin America, depressed economic and financial conditions, low valuations and debt-swap programmes have stimulated both buyer and seller interest in mergers).

20. Developing country enterprises take over enterprises in developed countries, or acquire minority stakes, mainly in order to obtain access to markets, distribution networks, technology, and essential raw materials or feedstocks. Public sector companies in Singapore and Taiwan Province of China appear to be motivated by additional considerations such as the investment of surplus funds and the building-up of strategic stakes in holding companies or well-managed foreign companies. Mergers among local firms in the Far East, with the exception of firms of the Republic of Korea, appear to have been motivated by the desire to undertake conglomerate diversification from declining industries, to rescue failing firms (where banks may play a role), or to acquire property-holding companies, as well as by speculative motives.

2. Privatization

21. The objectives of privatization in different countries have coincided to a large extent, although the breadth and the relative emphasis accorded to different objectives have varied from time to time and from country to country. The related objectives of raising capital and reducing recurrent budgetary expenditure have been crucial, particularly for developing countries (often in

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[23] See *Profits under pressure in Latin America*, *op.cit.*.

[24] See footnote 10.

the context of meeting adjustment conditionalities). Another related set of objectives has been the withdrawal of the state from commercial activity, and the development of the private sector, private investment and entrepreneurship, capital markets, and wider share ownership. It has also been hoped that this would send favourable signals to foreign investors. The attainment of efficiency at the level of individual enterprises has been a key objective, given the inefficiencies of many state enterprises, while it has also been hoped that the transfer of assets into private, competitive markets would promote efficient pricing of goods and services through the elimination of monopoly profits and would engender greater responsiveness of the economy to changing conditions. The above-mentioned objectives, however, have sometimes been in conflict. Such conflicts have arisen, for example, from the fact that it would usually be easier to obtain financial gains quickly from the sale of the most efficient and profitable state enterprises, or that a reduction in the monopoly powers of a state enterprise might deter potential purchases or reduce the price that could be obtained from its privatization, or might even reduce the viability of the enterprise.

C. Influence of industry, financial market and firm structures

22. The structural characteristics of a country's industry, capital markets and firm organization necessarily determine the extent to which acquisitions of control can take place and the type of acquisition favoured. The relative shares of the country's industry in public or private ownership, the number of firms, the relative weight of public companies, proprietary companies, partnerships or sole traders, and the concentration of ownership all determine what can potentially be acquired, while business or cultural habits, the existence of a stock market, the relative economic weight of quoted companies, the market liquidity and shares of active shareholders, the shareholding spread, the internal capital structure of companies, and the availability of finance all determine the ease with which acquisitions can be made. Traditionally, companies based in the United Kingdom and United States have been the most "open" to take-over; 99 per cent of the largest United States based firms are quoted on the stock market, for instance, as compared with 54 per cent of the largest European Community firms.[25] In some European countries, the existence of classes of shareholders without voting rights, relatively small fractions of active shareholders, the influence and shareholdings of banks or state-owned companies, family-controlled structures, or internal regulations of companies may tend to raise barriers against contested take-overs. Of course, some of these factors may sometimes make it easier to mount take-overs by reducing the number of shareholders to influence. The general trend in Europe appears to be towards a reduction in barriers to take-overs. However, in the United States, the powers of management to resist unsolicited bids have recently been strengthened in some states.

23. In developing countries, structural characteristics such as the relatively high proportion of industry in state ownership, the relatively small number of firms (out of which few are public limited companies accessible to outsiders), and the high concentration of ownership have all tended to limit the number of mergers taking place and favoured internal growth instead. Groupings of family controlled companies which control a relatively large share of industry are common in some developing countries. In general, the prevalence in developing countries of owner-management rather than professional management, cultural inhibitions that may exist about acquiring other firms (particularly through contested bids), the non-existence or small size of stockmarkets and difficulties in obtaining finance for take-overs would act as brakes to mergers. Of course, the extent to which such structural characteristics are prevalent varies from country to country. It should be noted that structures in developing countries have already changed somewhat, taking into account privatization, the larger number of firms operating in some more advanced developing countries, the greater size, sophistication and activity of stock exchanges, and growing capital accumulation in a few developing countries.

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[25] See Booz Allen Acquisition Services, *op.cit.*.

D. Possible future trends

24. In the 1990s, trends relating to acquisitions of control would of course depend upon broader macro-economic trends which are difficult to predict. Yet many of the macro-economic and technological factors that have contributed to the rise in mergers and joint ventures throughout the 1980s continue to exist. Merger activity has always been cyclical in nature, and the late 1980s may have seen the peak of one such cycle, at least in the United States and the United Kingdom. But it appears likely that, while less liberal finance may result in a decline in transactions undertaken for speculative or financial reasons (which may tend to reduce the size of transactions), the need for merged companies to divest some parts in order to reduce debt and to concentrate on core businesses and the opposite desire to expand geographical reach and to realize efficiencies will result in a continuing steady stream of deals. Shortages of venture capital in high-technology sectors could stimulate take-overs, particularly of start-up companies. Links among companies which have started off as joint ventures may be developed into mergers, although lack of finance for mergers may also encourage the formation of more joint ventures instead.

25. Taking into account the ongoing structural changes noted above, a gradual increase in the participation in merger activity of enterprises from some developing countries appears likely. Other factors that could play a role include these enterprises' desire to diversify from the United States market by acquiring European companies, growing "South-South" investment, which should occur in some cases through mergers, continuing liberalization of foreign investment régimes, succession difficulties of family-owned companies (these are also relevant in continental Europe) and growing "openness" of stock exchanges. Steady increases in joint ventures in developing countries should also continue, as the growth in the numbers and capabilities of local firms creates more valid interlocutors for developed (and other developing country) partners, although concerns about protecting technology and creating new competitors may act as a brake. However, the above observations are subject to the caveat that it remains to be seen what the impact of economic and technological changes will be on foreign direct investment volumes, directions and strategies. Moreover, if the present trends continue, many developing countries will continue to face stagnation in incoming flows of foreign investment, necessarily resulting in low rates of mergers and joint ventures involving foreign partners. However, given the size of assets in the public sector, financial problems and fundamental changes in concepts about the appropriate role of the state, privatization programmes look set to continue for a long time to come, with more and more countries implementing such programmes.

Chapter II

COMPETITIVE CONDITIONS IN MARKETS AND TRADING CHANNELS OF DEVELOPING COUNTRIES

A. Domestic markets and import channels

26. In assessing the effects of acquisitions of control upon the markets and channels of developing countries, the specific competitive conditions in these markets should be taken into account. It is of course true that there are sometimes very substantial differences in the conditions prevailing in respect of different developing countries, but their markets and trade channels do tend, with some exceptions, to have a number of competitive conditions in common, although the extent to which these conditions apply may vary. In general, domestic markets of developing countries are characterized by relatively low demand, because of either limited purchasing power, size and/or sophistication. This would be true both of ultimate and of intermediate consumers; the small size of industrial sectors would reduce demand for capital goods and producer services, for instance. Given relatively low demand, and given that the manufacture of most products requires minimum economic scales (MES) below which it would be uneconomic to produce, the number of firms in any particular sector that domestic markets in most developing countries would by themselves be able to sustain would be relatively low, resulting in a relatively high degree of concentration in different product markets.

27. On the other hand, import barriers to developing country markets may have the effect of reducing concentration by making it possible for more firms to produce locally for the domestic market on a sub-optimal scale; the higher prices possible in the absence of "imported competition" would allow higher unit production costs.[26] Despite import barriers, however, the market concentration/economies of scale relationship is a more significant entry barrier in developing than in developed countries, as was confirmed by a statistical comparison of the correlation between industrial concentration and size elasticities of output per employee (as a proxy for scale economies) in selected developed and developing countries.[27] This state of affairs may be affected by technological change, which may sometimes make it economic to produce for small markets. But in any event, the installation of flexible production machinery has been far more extensive in developed than in developing countries, and this is likely to remain the case.

28. Apart from low market demand, other market imperfections in many developing countries are limited supplies of managerial, technological and marketing skills, of raw materials, machinery and spare parts, and of capital, all of which would be foreclosed by already established firms. Entry barriers can also be constituted in developing countries by their relatively less structured distribution systems and transport and communications networks, which would reduce the possibilities for competition to arise from sources which are further away. The latter factor should be considered in conjunction with the generally poor information flows in developing countries, often leaving customers unaware of available cheaper prices or alternative products or product sources. Other factors in different developing countries which may reduce competition can be the lack of an entrepreneurial culture, the risk-averse behaviour of entrepreneurs seeking rapid returns from trading rather than long-term investment, regulations which restrict or discourage new market entrants, or the non-existence or inadequate implementation of controls on anti-competitive practices. Thus, in India, for example, it is reported that the four-firm concentration ratio is between 80 and 100 per cent in over half of the industries; this has been ascribed to licensing regulations

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26 See Condon T., and de Melo, J., "Industrial Organization Implications of QR Trade Regimes: Evidence and Welfare Costs", Working Paper No.487, World Bank, August 1990.

27 See UNIDO publication prepared by Forstner, H. and Ballance, R., *Competing in a global economy*, London, 1990, pp.145-148.

which restrict or delay new market entry.[28]

29. A comparison of the same industries in developing and developed countries found that, in many industries, there were inverse correlations between concentration and either or both the variables of level of industrial development and country size.[29] Such a finding would suggest that the effects of horizontal acquisitions of control would be greater in developing countries. Moreover, the relatively narrow economic bases and industrial structures of many developing countries, and limited input sources and distribution possibilities, would necessarily increase the effects of any vertical acquisition of control. Narrow economic bases would also magnify the effects of any conglomerate concentration arising across different economic sectors, taking into account as well the usually unbalanced economic structure of developing countries, leading to over-reliance on relatively few sectors.

30. It is true that competition from local production by foreign controlled firms can affect the extent of market concentration in developing countries. However, its impact may be limited in scope. In India, for example, TNCs' market shares are high in those branches of manufacturing characterized by a high degree of product differentiation (where brand goodwill is a potent competitive advantage), technology intensity or skill intensity.[30] Subsidiaries of TNCs are usually relatively larger, more vertically integrated and more profitable than locally controlled firms. In a few industries, however, locally controlled firms affiliated with large industrial houses and using technology licensed from abroad resemble their foreign controlled counterparts. This would suggest that TNC subsidiaries and local enterprises often concentrate upon different industry sectors or segments, with TNCs focusing upon segments where more prosperous customers accept higher prices. Ample confirmation exists of such a tendency in different service sectors within a number of developing countries; a dual market structure often emerges whereby an oligopoly of TNC affiliates service other TNCs and large local firms, offering expertise and world-wide networks and reputation, while local service firms compete intensely for smaller clients, offering lower price and cultural affinity.[31] But in some cases, local firms have managed to emulate TNCs' skills and to compete with them, while TNC competition has sometimes led to reduced concentration and lowering of prices by local firms.

31. In general, however, it would appear that competition between TNC subsidiaries and local firms often does not significantly reduce concentration of market power in many industry sectors or segments in developing countries, while in other cases, foreign competition may merely result in the replacement of a less efficient local oligopoly by a foreign oligopoly, which might even be benefiting from investment incentives. Much will also depend upon the regulatory environment, which may heighten barriers to entry against both foreign and local investment and thus enable the capture of monopoly rents. Even apart from such constraints, a number of economic factors have led to a stagnation of investment flows to many developing countries during the 1980s. The establishment of an attractive environment would be essential for foreign investment to occur, but equally, the establishment of a competitive environment would be essential if the benefits of foreign investment for competition are to be maximized.

32. Competition between domestically produced and imported goods in developing countries could have a more extensive effect upon market concentration than foreign investment (*see paragraph 58 below*), although imports may still be aimed at only certain sectors of the market, or (if they come from the same group as an established TNC subsidiary) avoid competing directly with goods produced by the subsidiary. Moreover, the effects of "imported competition" in reducing market concentration are often reduced, on the demand side, by foreign exchange shortages or fluctuations and lack of information on the available range of suppliers and, on the supply side, by such entry barriers as low market demand (reducing the numbers of foreign exporters, intermediaries and local distributors involved), transport difficulties and costs, tariffs, internal regulations, intellectual property rights, lack of market information, or distribution difficulties. When it is sought to import technology, the conditions governing access to it (e.g.

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[28] See "India Survey", *The Economist*, 4 May 1991.

[29] See Forstner and Ballance, *op.cit.*, pp.151-153.

[30] See, Kumar, N., *Multinational Enterprises in India, Industrial Distribution Characteristics and Performance*, London and New York, 1990.

[31] See UNCTC report, "Impact of transnational service corporations on developing countries" (E/C.10/1991/6). See also Sieh Lee Mei Ling, *op.cit.*.

technology export controls, suppliers' reluctance to transfer technology, intellectual property rights, limitations upon size or volume of production) would also be relevant. The use of restrictive business practices may also, depending upon individual cases, affect the contribution of imported goods to reducing market concentration in developing countries. Competition from imports would also, of course, not usually be relevant in service sectors.

33. Moreover, import penetration may also result in concentration of market power in foreign exporters to developing countries, taking into account that a relatively small number of large firms undertake the bulk of exports from some countries (i.e. export concentration in these countries is significantly higher than industrial concentration) and that only some of these firms would be exporting to individual developing countries.[32] High concentration also exists in import channels of developing countries. In Côte d'Ivoire, for instance, 11 per cent of importing firms (i.e. 33 firms) accounted for almost 62 per cent of total importation in 1983.[33] These importing firms include both locally owned and foreign owned firms. A significant proportion of developing country imports is, in fact, channelled through the foreign trade establishments or affiliates of TNCs, or through transnational trading corporations (TTCs).[34] TNC affiliates often act on an exclusive basis for the distribution of all the parent's products. In certain markets, and particularly smaller ones, they may also hold exclusive importation and distribution rights for products of other TNCs. In several sectors, the major TNCs have established global networks of trading affiliates.

34. Among TTCs, the share of agency houses in Western European exports to developing countries, although declining in recent years, continues to be around 10 to 20 per cent, with a relatively larger share of exports to small and low-income developing countries. Another type of TTC, the general trading company (such as the Japanese *sogo shosha*) handles a significant percentage of world trade. The share of the *sogo shosha* (some of whom form part of the *keiretsu*) in the total trade of Asian and Pacific countries, for example, was estimated at about 17 per cent at the beginning of the 1980s, although this share may have gone down since then; their shares of import trade (and profit margins) were relatively greater than their export trade shares and margins. Still another type of TTC, the commodity trader, is particularly prominent in the international trade of agricultural commodities, particularly in smaller developing country markets. The mergers that have taken place in the 1980s, both among TNC marketing affiliates (consequent upon the merger of their parent companies) and among TTCs, would therefore have had a direct effect upon concentration in developing country import channels. However, competition from some developing country traders has grown.

35. Apart from mergers, other arrangements that are affecting concentration in developing country import channels are: export joint ventures, cartels, or associations. Such ventures exist in several developed countries in a range of sectors,[35] and action has sometimes been taken against them by competition authorities in developed countries.[36] In general, however, it would appear that, at present, the numbers of such joint ventures, and the share of world trade affected by them, would be small. In the United States, for example, exports controlled by registered Webb-Pomerene associations accounted for less than 2 per cent of total exports in 1981.[37] In Germany, there were 42 export cartels still effective as of December 1988; one new cartel was authorized that year.[38] In the United States, 18 certificates of exemption from antitrust laws under the Export Trading Company Act 1982 were granted in 1988; it is difficult to assess how many export cartels exist in reliance upon their immunity under general antitrust law. Given the lack of transparency that often prevails, it is not clear to what extent developing countries are affected by such joint ventures. A 1978 report by the United States Fair Trading Commission mentioned that 16 Webb-Pomerene associations had government agencies or trading firms as customers in Eastern

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32 For data on the United States, see Lorstner and Ballance, *op.cit.*, pp.154-159. See also Department of Commerce, "Report of the President on Export Promotion Functions and Potential Export Disincentives", 1980, pp.5-10. For data on the United Kingdom, see Utton, M. and Morgan A., "Concentration and foreign trade", Cambridge, 1983.

33 See ITC report, "République de Côte d'Ivoire - Analyse du rôle et des performances des différents types d'entreprises dans le commerce extérieur", 1987.

34 See UNCTC report, "Transnational corporations in world development - trends and prospects" (ST/CTC/89), 1988, pp.383-389.

35 See *Competition and Trade Policies - Their Interaction*, OECD, Paris, 1984.

36 See *Competition Policy and Joint Ventures*, OECD, Paris, 1986.

37 *Ibid.*.

38 See UNCTAD, "Annual report 1989 on legislative and other developments in developed and developing countries in the control of restrictive business practices" (TD/B/RBP/61).

European or developing countries.[39] A court case in the United States involved a cartel for the sale of antibiotics formed by six pharmaceutical companies, which affected both the domestic and export markets, including India.[40] In another case involving India, its Monopolies and Restrictive Trade Practices Commission opened an enquiry in 1988 into a collusive tendering arrangement among some Japanese suppliers of steel rolls, which were alleged to have followed prices set by the Roll Exporters Association of Japan.[41]

36. Although the aggregate impact of such joint ventures may therefore at present be relatively small, taking into account the growing profusion of sources of supply, they may well be having a significant impact in specific geographical or product markets, particularly where the joint venture includes producers from different countries. There are grounds for believing their impact may increase in future (see chapter V of this study). On the other hand, it may be noted that export joint ventures established in developed countries may in some cases be having a beneficial effect upon concentration in developing countries by allowing SMEs to pool their exporting efforts, although it appears that they are little used by such firms and mostly include larger-than-average firms in concentrated industries.[42] Export cartels may also exist in some developing countries as a corollary of voluntary export restraints (VERs) undertaken in response to pressure from trading partners. VERs necessarily involve actions by exporting firms to limit the volume and, in some instances, to raise prices of exports of a given product to one country. However, there is a risk of "spillover" onto the domestic market where exporting firms exchange information to facilitate the operation of the VER, or where the export cartel comprises a large share of domestic industry output.

B. Export markets and channels

37. The competitiveness of developing country enterprises may be reduced by limited home demand and high prices for production inputs. Where technology needs to be imported for export production, the conditions governing access to technology (as suggested in *paragraph 32)* would also be relevant. In the process of exporting, developing country enterprises would also need to take into account clauses in licensing arrangements that may limit exports, or fix prices, as well as purchasing practices of firms, import cartels, customers' brand loyalty, and marketing, distribution and transport difficulties and costs, as well as tariff or non-tariff measures, procurement, licensing requirements, and product standards. The factors mentioned above may all heighten the normal disadvantages faced by latecomers *vis-à-vis* market incumbents, which have built up "learning economies" and "first mover advantages" from cumulative production experience and marketing intelligence.

38. Of course, it is not only developing country firms which face such entry barriers or other factors. Thus, the Structural Impediment Initiatives (SII) talks between the United States and Japan address such issues as the alleged tendency of interlinked Japanese companies to purchase amongst themselves, procurement policies in civil engineering projects, and distribution difficulties, while the French Government has recently complained about the alleged tendency of two United States-based telecommunications companies to purchase mainly from their affiliates.[43] Moreover, despite these above-mentioned factors, manufactured exports from developing countries as a group have grown rapidly, although such success has been limited to a relatively small number of countries. High export market penetration achieved by firms from some Asian countries has often been concentrated within a few major markets and in relatively few product areas, particularly in the electronics industry, thus increasing vulnerability to anti-dumping actions or VERs.

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39 "Webb-Pomerene Associations: Ten Years Later". Such an association is one formed under the Webb-Pomerene Act, which exempts from the application of antitrust law export trade associations formed for the sole purpose of engaging in export trade, provided they meet certain conditions.

40 *Pfizer Inc., v. Government of India*, 434, U.S.308 (1978).

41 See UNCTAD, "Annual Report 1989 ...".

42 See *Competition Policy and Joint Ventures*.

43 See "France attacks US telecom practice", *Financial Times*, 25/26 May 1991.

39. Other developing countries which have a high dependence upon the exportation of a few commodities may face tariffs rising in accordance with the degree of processing, or the activities of import cartels, which have occurred primarily in the raw materials sector.[44] Even apart from the activities of such cartels, however, a significant degree of market concentration exists in, for example, the coffee processing, tea blending and packing, and chocolate manufacturing industries.[45] In order to defend their market shares, the industry leaders in these areas use such strategies as product differentiation, price discrimination, heavy promotional activity, technology leakage controls and mergers. In the coffee-processing industry, for instance, the number of industry leaders operating within the EEC decreased from 18 to 4 between 1979 and 1988.[46] In general, however, the vertical integration that prevailed in past years, with TNC's exercising control over the whole chain, from production to processing, trade and distribution, has greatly diminished, particularly in respect of those agricultural commodities which are traded at low stages of processing.[47] The role of vertically integrated TNC's continues to be somewhat larger in respect of processed agricultural commodities (such as processed cocoa from Brazil and West Africa, sugar and tobacco from Zimbabwe, bananas from Latin America and the Philippines, or tea from India and Kenya). Commodity trade is much more concentrated that commodity production. International trading companies and commodity traders are particularly prominent in the trade of some agricultural commodities, such as tea, coffee and bananas. Around half of world coffee trade is carried out through them, for example, while the large processing companies account for most of the remaining half. However, private and public sector companies from many developing countries have come to play an increasingly important role in export channels for commodities. In general, the intensity of TNC involvement in commodity exports from developing countries varies according to individual countries and commodities, but continues to be relatively high, particularly in some African countries. Their role is also important in distribution and service activities.

40. In the area of manufactured goods, a substantial proportion of the products exported by developing countries are "dedicated" or "captive". Retailing firms in developed countries directly import an estimated 20 per cent of exports from the Asian region, for example,[48] thus providing strong competition to trading intermediaries. Subcontracting arrangements, including original equipment manufacturing (OEM), also account, depending upon individual countries, for a substantial share of manufactured exports. Intra-firm trade between TNC subsidiaries and their parents or other affiliates also accounts for a significant proportion of developing country exports, although usually less than developed countries' exports. In other export channels for manufactures, trading affiliates of TNC's and TTC's share the bulk of trade. The participation of developing country firms is relatively small, in overall terms, but is increasing, and is high in a few countries. It may be noted that TNC's and TTC's have strongly contributed to the growth of developing country exports.

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44 See *Competition Policy and Joint Ventures*.

45 See UNCTAD, "Prospects for the world cocoa market until the year 2005" (UNCTAD/COM/5); UNCTAD, "Studies in the processing, marketing and distribution of commodities: The processing and marketing of coffee" (TD/B/C.1/PSC/31/Rev.1), and UNCTAD, "The marketing and processing of tea" (TD/B/C.1/PSC/28/Rev.1).

46 See Booz Allen Acquisition Services, *op.cit.*, p.9.

47 See ITC publication, "Structural change in export marketing channels of developing countries", 1988; and "Transnational corporations in African trade: Major trends in primary commodities" (E/ECA/89/26).

48 See "Structural change in export marketing channels of developing countries".

Chapter III

EFFECTS OF ACQUISITIONS OF CONTROL INVOLVING LOCALLY ESTABLISHED FIRMS

A. Effects upon competition

41. In developing countries, it may often happen that the firms involved in mergers are so small that the effects upon market concentration are negligible. However, such mergers can have the effect of reducing market concentration where they allow smaller players in the market to attain the critical mass to win market share from a monopolist or oligopolist. Market concentration can also be reduced where a conglomerate merger enables an outsider firm to enter a concentrated market, where a vertical merger enables the firms involved to better compete against other vertically integrated firms, or where a management buy-out of part of a firm's assets results in the creation of an independent new entity.

42. On the other hand, market concentration may be strengthened where a horizontal merger enables an actual or potential competitor to be eliminated. A vertical merger can also result in the strengthening of concentration at either level of integration if it provides the possibility of exercising monopoly or monopsony power over existing of potential competitors, raising entry barriers to potential market entrants by obliging them to enter into the market at both levels. Conglomerate mergers can give rise to industrial concentration where there would otherwise have been a *de novo* entry into a market or where the financial backing of a wealthy parent enables the acquired firm to acquire or maintain a dominant position of market power. They can also raise aggregate concentration in the economy as a whole, so that economic power in the country is held in a few hands. The competitive conditions in developing country markets would heighten all these risks. The prevalence of owner-management in most developing country firms would also necessitate careful attention to be paid to the identity of owners, family affiliations and interlocks.

43. Joint ventures, although they would often result in the creation of a new entity, may have many of the positive or negative effects upon market concentration which mergers have. Negative effects may arise, for example, where a venture eliminates existing or potential competition among the participants in the area of activity covered by the venture, acts as a vehicle for a cartel, provides the participants with the opportunity to collude in areas other than the venture, or results in market foreclosure for competitors in a vertical venture. Much will depend upon the extent to which an individual venture involves activity close to the market place and upon its openness to participation, as well as upon the nature of the restrictions ancillary to the venture. A venture which would have little effect upon market concentration by itself may have a wider effect as a link in a chain of other ventures engaged in by the participants, while a merger may also have more significant effects where the protagonists are participating in joint ventures. It is particularly difficult to generalize about the effects of joint ventures because of the large diversity of types of ventures which exist.

44. Another category of acquisition of control, privatization, also raises complex issues. On the one hand, privatization may reduce the monopoly power of a state-owned enterprise, or remove the possibility that state control or financial backing may put the enterprise concerned in a more favourable competitive position than private firms. On the other hand, privatization may leave unchanged or even enhance existing concentration of market power, particularly where effective competition is not created or allowed in the sector (e.g. by not splitting up the enterprise, or by licensing restriction on new entry), where the enterprise concerned operates a natural monopoly such as a utility service, where the cost of new entry is prohibitively high, or where the privatized enterprise can take advantage of its established product name, the vertical integration of deregu-

lated activities with monopoly activities, or financial strength arising from such integration.

45. Higher market concentration would make it more likely that the new entity will raise prices unilaterally, or successfully collude (explicitly or tacitly) with the diminished number of other firms in the market to restrict output and raise prices, or practise predatory or discriminatory pricing or other restrictive business practices. Conglomerate mergers may increase "multimarket contact" among sellers competing in different markets, making more likely each firm's independent choice of the joint profit-maximizing solution. Of course, it does not necessarily follow that this will happen. Thus, a Brazilian car company (formed by a merger of the subsidiaries of two American and German car manufacturers) holding 60 per cent of the Brazilian car market has been found, after investigation by the authorities, not to have committed an "abuse of economic power" when it sharply raised its prices (since the prices were no higher than those of competitors), and also not to have adopted practices prejudicial to the market in its relations with its suppliers and consumers.[49] But strong concentration would certainly heighten the risk of anti-competitive practices.

46. However, an acquisition of control which leads to a greater market share may not necessarily lead to a durable acquisition or increase of market power by the new entity or a significant decrease in competition. Effective competition can continue to exist in oligopolistic markets. Recent or ongoing changes in the market which may arise, for example, from new entry or technological change may lead to a diminution of market share, as may internal financial or efficiency problems. Customers or suppliers may have countervailing buying or selling power. Any market power attained may not exist for a long duration, since it may induce customers to search for alternative products or product sources, or stimulate new entry. The very threat of this happening may deter abuse of a dominant position of market power. Much would depend upon entry barriers to the market (which are high in developing countries), its structure and its rate of growth.

B. Effects upon competitive efficiencies

47. Moreover, mergers can lead to greater efficiencies in relation to investment, management and organization, production, sales or technological innovation (these are of course interrelated). Not only may such efficiencies occur within the merging firms, but spin-off effects can occur within the industrial sector, among suppliers or even within the whole economy. Of course, competitive markets in themselves can provide the best means for encouraging economic efficiency by leading to the flexible allocation of resources among competing uses in accordance with consumer preferences or technological possibilities, by putting pressure on firms to perform efficiently and to innovate, and by protecting consumers from exploitation. In some circumstances, however, mergers or ventures may prevent or lessen competition while succeeding in realising efficiencies, necessitating a cost-benefit analysis. In other circumstances, of course, neither competition nor efficiency may benefit. Short-term "static" efficiencies may also be counter-balanced in the longer term by inefficiencies such as reduction in innovative abilities.

48. A merger represents an investment by the acquiring firm, although it would not directly add to the aggregate stock of investment in the same way as building a new plant would. Such an investment may be particularly beneficial where, for example, the firm taken over is a "failing firm" about to go out of business and where the acquirer is a conglomerate redirecting capital out of an industry with stagnant growth prospects into another expanding industry. Further capital injections may follow after the merger, helping to finance new plant or to provide necessary working capital. Mergers may also generate savings from pecuniary economies of scale and rationalization in administration and management. Size and/or diversification may also make a firm better able to raise capital and to reduce interest costs. On the other hand, a take-over may significantly weaken the financial position of the acquiring company (by contrast, a joint venture would be less expensive). A speculative merger may result in the dismemberment of a productive and efficient company. The profitability and growth of the merged company may suffer as a result of the acquisition, resulting in a long-term reduction in investment.

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[49] See "Autolatina beats anti-trust suit", *Financial Times*, July 1991.

49. A number of empirical studies indicate that most mergers lead to reduced market share growth, profitability, productivity, share valuations, and/or investment.[50] Other studies are inconclusive, or provide evidence of a certain improvement in market share or investment.[51] Horizontal mergers do appear to be more likely to be successful than other types of mergers. Management buy-outs have a higher chance of success, as they increase the incentive for managers to perform. In general, however, the only parties which have consistently gained from mergers are the shareholders of the acquired firm, who may or may not invest elsewhere.

50. An active take-over market may be a threat to inefficient incumbent managements, obliging them to improve the performance of their firms. Where a take-over does occur, it may shift the management of corporate assets to more efficient hands. Cost savings may be generated from rationalization and scale economies in management and administration. On the other hand, the possibility of a take-over may distract the managements of both acquiring and target firms from more productive activity and encourage defensive manoeuvres which are to the detriment of long-term investment. Where the take-over is consummated, the additional bureaucratic and hierarchical complexity and differences in corporate cultures may make the merged firm more difficult to run. One study suggests that the threat of take-over can be an effective spur to efficiency, but that actual take-overs do not lead to efficiency.[52] Joint ventures can be even more difficult to manage than mergers because of lack of clear authority, the transaction costs of co-ordination and conflicting objectives and interests. Non-equity ventures may reduce the commitment of the participants to their success. Such problems are one reason for the instability and brief duration of many joint ventures.

51. Mergers may lead to economies of scale in procurement and transport of production inputs and from increased volume, spreading of fixed costs, expansion of plant, and mechanization at higher levels of output; economies of scope from producing more than one product together; specialization within or among one or more plants, elimination of duplication, reduced downtime, and smaller stocking requirements; and the transfer of superior technology and production techniques, or the pooling of resources for their acquisition. Besides these static economies, there can be dynamic economies from learning effects associated with increasing experience of production. Production efficiencies have nowadays become increasingly affected by rapid technological and commercial changes, and in this respect, smaller firms may generally be better able to withstand demand shocks, since they have greater flexibility. Depending upon the sector, the installation of flexible computer-controlled machinery may either raise or lower minimum economic scale.

52. In horizontal mergers, the importance of such efficiencies will often depend upon the amount of capacity and the rate of growth in the industry. In a rapidly growing industry where capacity is insufficient to meet demand, the production efficiencies that can be realised through a merger would be far less (and the potential for adverse effects on competition higher) than in a slowly growing industry where there would be excess capacity even after the merger. In the intermediate area, where capacity and demand are not far apart, the production efficiencies that may result from a merger may be outweighed by the potential for anti-competitive consequences.[53] A vertical merger can reduce costs when production processes require closely integrated steps in the production chain, or through reductions in transport costs or uncertainties in supply. Moreover, market entry by suppliers into downstream industries can prove particularly fruitful by creating a two-way channel for information and production skills. However, in many instances, improved communications technologies may make it more efficient to source components from outside and to focus upon core functions in-house. Long-term close co-operation between buyers and suppliers (i.e. "vertical" joint ventures") has been a key factor in the competitiveness of many industries.

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50 See for example D. Mueller, *The Determinants and Effects of Mergers - An International Comparison*, Cambridge, Mass., 1980; D. Ravenscraft and F. Scherer, "The Profitability of Mergers", Federal Trade Commission Working Paper 136, Washington D.C., 1986; and R. Caves, "Mergers, takeovers, and economic efficiency: Foresight vs. hindsight", *International Journal of Industrial Organization*, Vol.7 (1989), pp.151-174.

51 See M. Kumar, *Growth, Acquisition and Investment*, Cambridge, 1984.

52 See P. Holl and J. Pickering, *The Determinants and Effects of Actual, Abandoned and Contested Mergers*, University of Manchester, 1986.

53 See M. Dutz, "Horizontal mergers in declining industries, theory and evidence", *International Journal of Industrial Organization*, Vol. 7, pp.11-33, (1989).

53. A merger or joint venture can rationalize publicity, marketing, distribution and servicing activities, particularly in exporting. A vertical merger can result in guaranteed markets for sales and secure channels for distribution, although the foreclosure of the production of the supplier firm can reduce its scale economies. However, such efficiencies are not a guaranteed result of mergers and joint mergers. As noted in paragraph 49 above, the past record of mergers in increasing sales and market share is often not good. Moreover, there is a strong correlation between vigorous domestic rivalry and the creation and persistence of competitive advantage in an industry; this is true not only in fragmented industries but also in those with substantial economies of scale.[54] Such economies are best attained in overseas rather than domestic markets. Few "national champions" are internationally competitive without protection and subsidies. However, strong rivalry may exist even where there is an oligopoly (see the experience of the Republic of Korea in the annex).

54. The fact that lack of competition may reduce the competitiveness of firms is demonstrated by a study on the United Kingdom's international trade, which found that import growth was particularly high in sectors where there was high and persistent concentration, except in capital-intensive sectors.[55] The inverse correlation between concentration and competitiveness in export markets was even stronger. While oligopolies of large firms were more important in markets where export levels were also significant, their performance in export growth was relatively poor, even allowing for the fact that they were starting off from higher absolute levels. Export performance was particularly poor in product sectors where high concentration was coupled with high import protection, or where there was a low local presence of foreign TNCs, suggesting that lack of competition in home markets decreases competitiveness in export markets. However, where product concentration had reached moderate levels as a result of a rapid increase from a comparative low level, export performance was well above average, suggesting a "threshold" effect.

55. Mergers and joint ventures may lead to efficiency in innovation by providing resources, complementarities and economies of scale and scope in research and development (R & D), thus encouraging more ambitious projects and "in-house" technology transfer and reducing the problems of imitation and the social costs of duplicative research efforts. Moreover, market concentration and barriers to entry may encourage innovation because lesser fears of imitation may provide the security necessary for a firm to engage in research and development investment. Risks may also be lowered by the fact that large firms involved in relatively more innovation projects would have a better average chance of success in some of them. Diversified firms may be better able to make use of innovations in several lines of business.

56. However, much of research and development is not characterized by substantial economies of scale. Moreover, in many circumstances, small firms tend to be more innovative than large firms since, without competitive pressure, sunk costs and bureaucratic inertia would make the large firm stick to existing successful product lines. Moreover, increasing the number of firms undertaking research and development increases the probability that a larger number will be successful. But in general, a diversity of firm sizes is perhaps the most conducive to innovative activity, with much depending upon individual sectors.[56] Whatever the advantages of large size may be, the evidence indicates that mergers often result in a reduction in research and development investment.[57]

57. Some guidance as to appropriate cases for mergers in developing countries may be provided by a report by the National Bank of Egypt, which suggests mergers as a possibility where Egyptian enterprises which are otherwise competitive suffer from such problems as lack of optimal size or insufficient cash flow, or from external factors such as stagnation in demand, shortage of foreign exchange for importation of inputs, or unexpected price fluctuations.[58] On the other hand, it is cautioned that mergers would be inappropriate for non-viable enterprises which have exhausted all their assets, or possess huge idle stock because of lack of present or potential future demand, or are unable to compete in export markets; in such cases, liquidation would be the proper solution. Where enterprises are still competitive, it is suggested mergers could be weighed against

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54 See M. Porter, *The Competitive Advantage of Nations*, London, 1990.

55 See Utton and Morgan, *op.cit.*

56 See Z.Acs and B. Audretsch, "Accounting for the differences between large and small firm innovation", *International* Institute of Management discussion paper, Berlin, 1986.

57 See also National Science Foundation, *Annual science and technology report to the Congress 1988*, Washington D.C.

58 See National Bank of Egypt, "Mergers of Joint Stock Companies: Economic Considerations and Impact on Ailing Companies", *Economic Bulletin*, pp.135-143, vol. XXXXI, No.3, Cairo (1988).

other solutions such as financial participations, the creation of holding companies to own firms which enjoy managerial independence, or cooperation in marketing activities. But it is recommended that a thorough feasibility study should be undertaken on a case-by-case basis before the appropriate solution is chosen, with the banking system undertaking a key role.

C. Relevance of imports

58. In many cases, competition from imports would diminish concerns about anti-competitive effects of acquisitions of control. Such competition would provide market discipline for any anti-competitive conduct that might be practised.[59] Conversely, acquisitions of control may allow developing country firms to improve their efficiency and competitiveness, thus reducing the market power of foreign exporters. Indeed, foreign competition may itself strengthen industry concentration by reducing prices, thereby leading to market exit by some local firms and more intra-industry specialization and trade by TNC subsidiaries. Thus, in Chile, import liberalization between 1967 and 1979 led to a decrease in the mean price-cost margin from 48 to 32 per cent, an increase in the 4-firm concentration ratio from 49 to 61.5, a decrease in the number of firms, and an increase in intra-industry trade.[60] Similarly, in Brazil, where recent tariff cuts have led to complaints about reduced competitiveness, a United States-owned manufacturer has had to reduce its prices and is now weighing the costs and benefits of producing each product locally rather than importing.[61]

59. However, foreign competition is far from being a perfect substitute for domestic competition because of entry barriers (see paragraph 32 above). Some products are inherently local or national in character because of transport costs or specific local requirements. This would be even more true of services such as distribution. RBPs can also limit the effect of imports. Thus in Mexico, substantial tariff reductions have not brought domestic prices into line with international ones because, *inter alia*, of limited distribution channels, the quasi-monopoly of existing channels by "traditional" importers, and TNCs' discriminatory price policies.[62] The initial experiences of Argentina would indicate that competition from imports may be more effective in lowering manufacturers' input prices than retail prices.[63] Even in developed countries with a large import share, such as Norway, there is ample evidence that imports do not always result in more effective competition, partly because of differing costs, but mainly because foreign exporters may take advantage of high domestic prices to reap monopoly profits. The situation has been well summed up in the following words "... if competition is efficient in a market, the existence of international trade will strengthen and maintain the competition. If the competition situation is very weak, imports alone will not improve matters much".[64] Moreover, premature exposure of developing country firms to "imported competition" may decimate infant industries and lead to concentration of market power in foreign exporters, or trading intermediaries, particularly where "dumping" or government-subsidized pricing occurs. Whether this would be the case would depend upon the competitiveness of developing country firms.

60. Moreover, acquisitions of control may lead to lesser rather than greater competitiveness of local firms, either by lowering their efficiency, or by reducing the competitive incentive for them (see paragraphs 53 and 54 above). Whatever the advantages of large size may be, therefore, the advantages of "organic" internal growth would need to be weighed against such advantages of external growth as speed and rationalization of excess capacity. Mergers among suppliers can also heighten the vulnerability of the whole industry cluster which they are servicing, or even of the

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59 See A. Jacquemin, "Mergers and European Policy", in Jacquemin et al., *Mergers and Competition Policy in the European Community, Oxford, 1990*, p.21 (see also annex).

60 See Condon and de Melo, *op.cit.*

61 See "Business Latin America", *Business International Inc.*, 8 October, p.318.

62 See de Mateo, F., "Trade, Technology and Competitive Opportunities", in *Competition and Economic Development*, OECD, Paris, 1991.

63 See "Painful embrace of a competitive transformation", *Financial Times*, 18 June 1991.

64 See Bakke, E., "Competition and International Trade", in *Competition and Economic Development*.

whole economy. Thus, in Australia, where a merger of the two companies which produced springs for cars had been allowed, the whole car industry was brought to a standstill two years later when the company workers went on strike; imports were not competitive because of tariff protection.[65] Vertical integration with inefficient supplier firms, rather than importation of cheaper inputs, may also weaken competitiveness, as in Brazil.[66] But vertical integration may sometimes increase competitiveness: in Mexico, for instance, it has been suggested that, since the strengthening of the patent system, taking effect in 1997, is likely to lead to a rapid expansion of foreign investment in the pharmaceuticals sector, the strategy of Mexican-owned laboratories should be to form vertically integrated groups through mergers, which would give them a sufficient economic base to acquire new technology and to undertake research.[67] It is forecast that laboratories which remain isolated will find it difficult to survive, taking into account difficulties in penetrating the United States market. But certain options which could remain open to them include the installation of small multi-purpose laboratories (concentrating on economies of scope rather than of scale) supplying larger producers, and the establishment of export trading companies specialising in products from Mexico's botanical resources. There is thus no hard and fast rule that can be stated regarding the relative advantages or disadvantages of mergers and joint ventures.

D. Mergers or joint ventures of locally controlled firms with TNC subsidiaries

61. These would not in principle raise different issues regarding market concentration than mergers among locally controlled firms. The same would be true of mergers among subsidiaries of different TNCs. However, the usually relatively larger size of subsidiaries, coupled with the fact that they might often be interested in taking over large and/or competitive local firms, may be more likely to lead to market concentration from a merger. It sometimes happens that TNCs buy out "troublesome" local competitors. Thus, in Argentina, a Dutch electronics firms allegedly took over a local competitor to dismantle it.[68] As regards efficiencies, these would not substantially differ from situations where the TNC is a new market entrant, and will therefore be dealt with in the following chapter. However, it may be noted that an established TNC subsidiary may be less likely to use foreign exchange for take-overs than would an incoming TNC, thus decreasing efficiencies arising from investment. On the other hand the greater local knowledge of an established subsidiary could improve managerial efficiency and the general success of the merger, while production efficiencies and economies can also arise. Where a locally controlled firm takes over a TNC subsidiary, or a management buy-out takes place, reduced TNC involvement would obviously decrease access of the former subsidiary to the "firm-specific assets"[69] of the TNC, but continuing collaboration is common.

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[65] See the report of "The 3rd Conference on Antitrust Policies in the Asian and Oceanians Countries", Seoul, 1989, p.52.

[66] See W. Fritsch and G. Franco, "Efficient industrialisation in a technologically dependent economy: the current Brazilian debate" in *Competition and Economic Development*.

[67] See W. P. Nunez, *Foreign Direct Investment and Industrial Development in Mexico*, OECD Development Centre, Paris, 1990.

[68] See consultant study prepared for the UNCTAD secretariat by Mr. E. White.

[69] Assets of an intangible nature such as managerial skills, technology, brand names, or marketing networks and know-how.

Chapter IV

EFFECTS UPON MARKETS OF DEVELOPING COUNTRIES OF MERGERS/JOINT VENTURES OF LOCALLY ESTABLISHED FIRMS WITH FOREIGN FIRMS

62. A merger or joint venture within a developing country between a locally established firm and a new market entrant, usually a TNC, would not effect market concentration unless the new entity produced wholly or partly for the domestic market. Where this is the case, the new entry may be beneficial by providing a healthy competitive stimulus to concentrated markets, subject to what has been noted previously in paragraphs 30 and 31 about the limitations on the extent of competition between TNCs and local firms. On the other hand, the new entry may strengthen concentration where the TNC (through imports) and the locally established firm had been competing in the same sector, or would have competed but for the merger or joint venture, i.e. if the TNC would otherwise have begun exporting to the country concerned or would have undertaken a greenfield investment[70] (in practice, of course, it may be difficult to ascertain what the TNC might have done). The new entry may also lead to future concentration where premature exposure to the superior competitive ability of the TNC leads to the decimation of the infant industry of the developing country in that particular sector. The replacement of a local oligopoly by a foreign controlled oligopoly would hardly benefit competition. But much would depend upon the competitiveness of local firms; their local knowledge may give them an advantage, while they may merge in reaction to the competitive threat of the TNC.

63. As regards efficiencies, the take-over of a local firm by a foreign firm may represent an infusion of investment into the economy, although greenfield investment representing an addition to existing capital stock may be preferable, particularly in developing countries where there may be a shortage of alternative investment opportunities and where capital flight may be a possibility. The questions of "additionality" of foreign investment and capital flight have been of concern in relation to debt-equity swaps in particular, since the discount inherent in the swap may susidize investment that would have taken place anyway; however, it appears likely that at least part of the investment undertaken through swaps has been additional.[71] Where, however, finance for a take-over by a foreign firm comes from its local earnings or borrowings, there would be no new investment in the country (although earnings might have been repatriated), while local borrowing may in fact crowd out local companies and thus have an adverse impact upon local capital formation, particularly since (unlike in developed countries) most developing country firms would not have the possibility of raising capital in international financial markets.

64. To put the question of the provision of investment capital through take-overs by foreign companies into perspective, it may be noted that foreign direct investment as a whole contributed only 3 per cent of gross fixed capital formation in developing countries in 1980-1984, and 17 per cent of long-term capital inflows in 1980-1985.[72] However, this should not obscure the fact that, at the level of individual firms, a take-over by a TNC may sometimes be the most readily available source of investment finance. The take-over of a local firm by a TNC is hardly likely to strain the latter's investment capacity. It may also be noted that there is little evidence that TNCs are any more likely than local firms to "disinvest" and disengage themselves from the local economy. On the other hand, they would tend to re-invest less of their earnings and remit more funds abroad than local firms[73], although this may depend upon growth prospects.

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70 Such a likelihood was the reason why a joint venture in the United States between an American and a Japanese company was invalidated (Brunswick Corp., *et al.*, 94 F.T.C. 1174 (1979), *Aff'd sub nom Yamaha Motor Co.Ltd v. FTC*, 657 F. 2d 971 (8th Circ. 1981)).

71 See "Transnational banks and debt-equity conversions".

72 See "Transnational Corporations in World Development", p.138.

65. A take-over of a local firm by a TNC would usually lead to the transfer of some "firm-specific assets". Transfers of organizational and managerial skills would be particularly important in view of the growing diffusion of new organizational methods (such as "just-in-time" systems and closer supplier-customer relations) and the large contribution these methods could make to efficiency and productivity in developing country firms. However, these new methods require a lot of managerial and engineering skills. The available evidence indicates that TNCs train a large percentage of the workers they employ but that, in many cases, the transfer of skills is incomplete, particularly in high-level management and engineering functions.[74] On the other hand, TNCs may provide better training in such functions than local firms. Where such a transfer of skills does occur, it may also eventually lead to a diffusion of these skills within the local economy. The above benefits of improved management and organizational skills may, however, be vitiated to some extent by the management difficulties of mergers and joint ventures referred to in paragraph 50 above, which may well be magnified by distance and cultural unfamiliarity. On the other hand, many joint ventures in developing countries work well without such difficulties, perhaps because conflicts of interest among the joint venture partners are not as sharp as in ventures among developed country firms which are potential competitors.

66. A take-over of a local firm by an incoming TNC could give rise to intensive technology transfer, often on concessional terms, to the new subsidiary, to a greater extent than would have occured in arms-length transfer arrangements. This would be particularly important in respect of advanced technologies which would otherwise not be transferred. It is true that confidentiality precautions are sometimes taken even in respect of technology transfer to subsidiaries, and that transfer pricing abuses have occurred in respect of royalty payments by subsidiaries. But by and large, a take-over by a TNC can be expected to be beneficial in terms of technology transfer to the subsidiary. Joint ventures have also led to much technology transfer, although perhaps not to the extent hoped for by local parties. Whether these benefits will extend to some extent within the industry sector will depend upon technology transfer by the subsidiary, linkages the TNC maintains with local suppliers (see paragraph 69 below) and the extent to which emulation by local firms occurs, or employees leave to found their own firms. Contrasting experiences have occurred in different countries in this respect. Indeed, in many instances, licensing, turnkey projects or joint ventures may be better means of acquiring technology than a merger. However, mergers may sometimes be the only way to acquire technology from another firm, given the greater importance attached nowadays to maintaining control of key technologies, and given difficulties in licensing complex technology.

67. Where entry into overseas markets is difficult, mergers or joint ventures with foreign firms can overcome entry barriers and provide access to distribution channels, brand names and market knowledge. The fact that, in Latin American countries, exports by United States majority-owned TNC affiliates have grown faster than total exports would indicate the TNC affiliates are relatively less hampered by entry barriers to export markets (at least their home markets) than local firms, as would the fact that the largest export contribution of Japanese, Swedish and United States affiliates in developing countries from all regions has been in more technology-intensive sectors.[75] It is true that, in some Asian countries, total exports have grown faster than those undertaken by United States majority-owned affiliates, but this would not take into account minority stakes, joint ventures and non-equity arrangements, or exports by TNCs from other countries. Not only would a TNC find it easier to overcome entry barriers to export markets, but it would also be able to make intra-firm sales; for example, 93 per cent of the imports into the United States in 1982 by local TNCs from developing countries came from majority-owned foreign affiliates.

68. On the other hand, there may be market foreclosure through TNCs' internal market allocation arrangements, while under-invoicing could also occur. To the extent that market allocation is compatible with specialization and comparative advantage, efficiency (and structural adjustment at the country level) would be enhanced (although comparative advantage is often created). But what may be efficient in the context of a TNC's worldwide operations may not be efficient for its subsidiary or for the host country. As an OECD study has pointed out, freedom of the component entities of TNCs to act as local profit centres, consistent with the need for specialization and sound

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73 See R., Grosse, *Multinationals in Latin America*, London and New York.

74 See "Transnational Corporations in World Development," p. 180.

75 See UNCTC publication, *Transnational corporations and manufactured exports from developing countries* (Sales No.E.90.II.A.21), by M. Blomström.

commercial practice, could yield significant benefits for international welfare.[76] Where this freedom does not exist, a take-over by a TNC of an efficient local firm involved in exporting may prevent it from attaining optimal exporting capacities.

69. Efficiency in sales would also need to be looked at within the context of the industry cluster within the host country. A TNC subsidiary may have a higher tendency to source from related firms than from local suppliers. Thus, TNCs based in the United Kingdom have a higher import propensity than local firms,[77] while United States parents generally run surpluses in their intra-firm trade with their affiliates, except with those based in some Asian countries. On the other hand, in Venezuela, local firms were found to be more likely than TNC affiliates to import from foreign sources,[78] possibly because of performance requirements placed upon the latter. Much would of course depend upon the competitiveness of local suppliers. Purchasing practices of TNCs may also give rise to transfer pricing abuses, although there is no evidence that these are a significant motive for intra-firm trade.[79] A key question in individual take-overs by TNCs may therefore be whether any higher propensity to import is likely to be compensated by greater exporting efficiency.

70. Conflicts of interest in overseas sales can also arise in joint ventures. Thus, in the petrochemical sector, it has been pointed out that reliance by some developing country producers upon joint ventures with major oil companies for marketing in developed countries carries the risk that, in their own interest as producers of the same product, the TNCs concerned will follow non-disruptive marketing strategies which will limit exports, maintain prices and restrict demand.[80] However, tariff and non-tariff barriers and the cost of developing independent marketing channels have so far limited other strategies. Despite such problems, there is little doubt that, overall, joint ventures have made strong contributions to exports by developing country firms.

71. Mergers and joint ventures between local firms and TNCs may be beneficial in research and development terms. TNCs undertake only a small percentage of their total research and development in developing countries, and usually only of a simple character (except in a few countries). Local firms would naturally be more prone to undertaking their research and development locally. In practice, in most developing countries, the research and development performance of local firms is poor, while their research and development abilities would certainly be less than those of TNCs. However, where a local firm taken over was efficient and innovative, the take-over may eliminate the possibility of the development of indigenous technological capability; such a consideration would be particularly important since developing countries have limited technological resources. Joint ventures may also lead to over-reliance on the technology provided by the foreign partner and the abandonment of efforts to innovate and adopt the technology to local needs.

72. Overseas mergers or joint ventures undertaken between local and foreign firms would rarely raise competition issues in the domestic markets of developing countries, unless the two firms had previously been competing in export trade to the developing country in question. As noted above, such arrangements are mainly undertaken with a view to obtaining access to technology or overseas markets. Anecdotal evidence would indicate that, while some mergers have been successful in achieving such objectives, others have experienced management or cost problems. Realistically, very few developing country firms would have the means to take over firms in developed countries which are large enough to raise competition concerns.

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76 See *Competition and Trade Policies*.

77 See UTTON and Morgan, *op.cit.*

78 See R. Grosse, *op.cit.*

79 See "Transnational Corporations and manufactured exports from developing countries".

80 See UNIDO, "International Trade and the Marketing of Petrochemicals", *Third Consultation on the Petrochemical Industry*, UNIDO/PC.R8, Vienna, November 1985.

Chapter V

EFFECTS UPON MARKETS OF DEVELOPING COUNTRIES OF MERGERS/JOINT VENTURES OF FOREIGN FIRMS

73. Some mergers and joint ventures occuring in developed countries in the 1980s, even where they have not had anti-competitive effects in the home countries of the firms involved, have resulted in market concentration in other countries or at the world level, particularly where they have led to restrictions on the freedom of affiliated firms to compete in certain product or geographical markets. They have also heightened possibilities for collusive arrangements among the fewer firms remaining in different markets, although such possibilities have probably yet to be fully exploited. The Director-General of Fair Trading in the United Kingdom[81] has indicated that, while the liberalization of European and international trade has diminished possibilities for cartels to be formed at the national level, the danger that monopolies, cartels and anti-competitive behaviour will re-establish themselves on a European or a wider international level deserves to be taken seriously. Such cartels may be harder to organise than national cartels, but modern communications would reduce such difficulties. The Director-General, on the basis of the enforcement activities of the European Commission, has suggested that certain industries are particularly prone to international cartelisation, such as those manufacturing industrial commodities where products and prices are uniform; products where production is highly concentrated; products where technological change is slow; and products where most producers are TNCs which would otherwise meet one another in competition across national frontiers.

74. In addition to such sectors, overseas mergers may have a particularly strong impact upon domestic markets of developing countries in international trade channels (because of concentration among trading intermediaries) and in sectors such as some commodities, some services (because lack of tradeability may limit competition) and high-technology areas. In Pakistan, for example, upon investigation of why the share in tea imports of Kenyan tea had almost trebled in three years while prices were substantially higher than international market prices (even allowing for the high quality of Kenyan tea), the Monopolies Control Authority found that the subsidiaries of two TNCs controlled over half of tea imports (most tea in Pakistan is imported), that their parent companies had been taken over by a third TNC, and that the prices of the tea imported from their Kenyan affiliates were higher than the prices paid to other sellers.[82] In the airline industry, it has been stated that "many proposed mergers and alliances between leading European airlines look suspiciously like mutual non-agression pacts intended to pre-empt the advent of freer competition by securing dominance in traditional markets".[83] In the auditing service sector, the largest six accounting firms, which have undertaken mergers in recent years, receive 40 per cent of world revenues.[84] Such concentration does not imply a lack of competition; audit fees have dropped in most countries in the 1980s. It remains to be seen whether they will continue to drop in the years ahead. The full effects upon developing country markets of many overseas mergers and joint ventures that have taken place during the 1980s will only become apparent during the present decade, as market conditions evolve.

75. It is in high-technology sectors where the effects of overseas mergers may be the most important, since the merging firms are also involved in networks of joint ventures, supply sources are limited intellectual property protection and technical standards are important, and increasing product market segmentation may be limiting substitution possibilities, while developing countries' limited capabilities would usually preclude the build-up of domestic sources. The conditions for obtaining "high-tech" inputs, while relevant to developing countries' import trade and domestic

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81 See the "Annual Report of the Director General of Fair Trading 1988".

82 See "Corporate behaviour in restraint of trade of goods and services in Pakistan", consultant study prepared for the UNCTAD secretariat by Mr. A. Riaz.

83 See "Ventures without frontiers", *Financial Times*, 18 October 1990.

84 See T. Noyelle, "Business services and the Uruguay Round negotiations on trade in services", in UNCTAD publication, *Trade in services: Sectoral issues* (UNCTAD ITP/26), 1989.

markets, would also often determine competitiveness in export markets. In the biotechnology industry, over 400 seed companies have been bought up, mainly by agro-chemical and food-processing firms (which have themselves undergone a wave of mergers). The plant breeding industry still shows a relatively low-level of concentration, but further consolidation is likely, and the implications for agriculture remain to be seen. In the semiconductor industry, particularly in Japan, forward linkages with electronic equipment producers, especially computer companies, have helped to smooth out demand fluctuations through "privileged customer" networks, to coordinate design requirements and to improve "speed-to-market";[85] there may also have been cross-subsidization. A corollary of such efficiencies in the performance of these firms, however, is that semiconductor and electronics firms in the Republic of Korea have become dependent for their supply of core components (such as microprocessors) upon the very firms with which they are competing.[86] Some American firms may also be in such a situation. Complaints have been voiced about difficulties in obtaining the latest technology and about pricing. It is reported that, in the United States, a large manufacturer of microprocessors and a large supplier of personal computer software are under investigation by the Federal Trade Commission for alleged anti-competitive practices.[87] It may also be noted that inter-firm licensing and joint ventures in the DRAM[88] industry have declined since the early 1980s, while there is a general reluctance to transfer advanced technology to firms from some Asian countries.[89] It is in this context that grounds for concern may arise from the "solar system" theory of the future of the computer industry, which holds that only two United States and two Japanese computer manufacturers will remain by the end of the century, and the rest will have been pulled into their orbits through mergers; the theory has recently been strengthened by the series of three joint ventures entered into by a large American computer manufacturer.[90]

76. Of course, it is true that the fluidity of technological change may rapidly reduce market power acquired through mergers and joint ventures. The convergence among different sectors in the fields of telecommunications, electronics and computers also makes it easy for firms from convergent sectors to enter specific product markets. Fierce competition occurs in these sectors at present. Yet such competition among oligopolists may not necessarily extend to all products in all geographic markets. It has been suggested, for example, that in the telecommunications sector, a joint venture involving three European firms, which has enabled the participants to compete better against the market-dominant firm (dominance arising from a recent merger) in the European Community as a whole, may have also facilitated collusion with the dominant firm in the French market.[91] Such arrangements are not new; a 1980 report by the European Commission highlights the development of a new form of oligopolistic specialisation at transnational level in which elements of competition are closely bound up with elements of technical or commercial co-operation and quasi-monopolistic rigidity.[92] But recent trends have increased such possibilities. Any adverse effects of market concentration in high-technology sectors may therefore vary among different products and markets, but there would appear to be risks for developing countries in mergers and joint ventures in such sectors.

77. Such risks would also extend to their export markets and channels. The growing importance and closeness of supplier networks in the electronics/informatics sectors would reinforce the importance for developing country exporters of belonging to these networks. One leading United States semiconductors producer, for example, has reduced the number of suppliers from around 6,000 in 1980 to 1,000 now, out of which 400 are identified as key or preferred suppliers.[93] Dis-

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85 See D. Ernst and D. O'Connor, *Competing in the Electronics Industry - The Experience of Newly Industrialising Economies*, OECD Development Centre (forthcoming).

86 See D. Ernst and D. O'Connor, *Technology and global competition*, OECD Development Centre, Paris, 1989.

87 See "Intel faces anti-trust investigation", *Financial Times*, 1 July 1991.

88 Dynamic Random Access Memory semiconductor chips.

89 See "The relevance of recent development in the area of technology to the negotiations on the draft international code of conduct on the transfer of technology" (TD/CODE TOT/55).

90 See "IBM explores PC frontiers", *Financial Times*, 11 July, 1991.

91 See Commission of the European Communities, "L'évolution de la situation concurrentielle consécutive à certaines fusions dans les secteurs de l'automobile et des télécommunications", Brussels, 1989.

92 See Commission of the European Communities, "Ninth Report on Competition Policy", Brussels, 1980.

93 See Ernst and O' Connor, *op.cit.*.

94 See ESCAP/UNCTC Joint Unit, "Transnational corporations and the electronics industry of ASEAN countries" (UNCTC *Current Studies*, Series A, No.5), 1987.

tribution networks for computers in Europe and the United States are also currently experiencing a substantial increase in mergers. The entry barriers to exports and distribution in this area make market entry difficult for developing country firms, hence the acquisitions in the distribution sector made by some developing country firms, as noted in paragraph 7 above. The above trends may not all be to the disadvantage of developing countries. They may help some foreign firms to compete better against other market-dominant firms trading with developing countries. In the past, mergers among retailing chains in developed countries have made it easier for them to establish buying offices in developing countries, thus reducing concentration in export channels. Foreign investment benefits may also flow from a merger. Thus, when a large United States telecommunications company took over a semiconductor subsidiary of another large United States computer company, it also acquired the subsidiary's assembly and test facilities in Thailand and Singapore.[94] It then made a major new investment in automated assembly in Thailand, and also plans to invest in design and wafer fabrication facilities in Singapore, where it will also make telephone sets. This would suggest that countries which are host to subsidiaries of TNCs may be better off when the TNCs' they merge or undertake joint ventures than countries which have no such subsidiaries and which may yet be affected in their foreign trade. This would be the case whether the merger or joint venture has positive effects for them, as in the above example, or negative effects, as in the example provided in paragraph 74 above (where the Pakistani authorities discussed restructuring possibilities and the withdrawal of a brand name with the TNCs concerned).

78. Indeed, where overseas mergers might otherwise have negative effects upon the markets of an individual country, constructive intervention by competition authorities can create positive opportunities. Thus, in a merger of a United States firm with the French subsidiary of another United States firm, an antitrust suit challenging the acquisition of a Californian chemical plant from the French subsidiary was settled through a divestment of the plant, with an undertaking to help the new owner to set up a research and development laboratory, to advise him on production and to help him to hire and train staff to restore competition in the business.[95] Realistically, however, in many instances, particularly in high-technology areas, TNCs prefer to trade with developing countries rather than to manufacture there. In Germany, cases of purely foreign mergers, i.e. those in which no local subsidiary or at least some production facility exists in Germany, but which nevertheless have serious anti-competitive effects in the country, have been rare.[96] But what would be true for a country like Germany may not necessarily be so for most developing countries. Information exchange, consultations and cooperation with the competition authorities of developed countries would therefore appear essential for developing countries to take appropriate action in respect of overseas mergers.

79. Apart from such direct action, one possibility for developing countries affected by concentration of market power in foreign exporters would be to organise countervailing import joint ventures. This is sometimes done in developed countries. Joint buying pools to countervail the power of foreign suppliers regulate, for instance, the importation of sulphuric acid into the United Kingdom, or sulphur in Australia.[97] Realistically, however, it is only in rare cases that the market power of firms from a single developing country would be sufficient to make an appreciable difference; cooperation with other countries would be necessary. The possibility of competition proceedings being taken against such buying pools in other countries would also have to be taken into account. Another possibility, the take-over of small firms in developed countries, would not be a valid option for most developing country firms, but there would be rather greater possibilities for establishing trading contacts and joint ventures with developed country SMEs, particularly if support were available from the Governments concerned. The strengthening of trading and investment links among developing countries and with the countries of Eastern Europe would also certainly help. Still another option would be to promote the integration of developing country firms within the networks of mergers and "strategic alliances" among developed country firms. In most cases, developing country firms would not be considered to be valid interlocutors for participation in such networks, but in certain cases, mergers among local firms may help to open up such possibilities. The above-mentioned options are not mutually exclusive; an integrated approach would probably be the most effective. Close consultations and cooperation with other Governments would be a *sine qua non* for the exercise of any of the options mentioned above.

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95 See *International Mergers and Competition Policy*, OECD, Paris, 1988, p.38.

96 See "Activities relating to specific provisions of the Set of Principles and Rules" (TD/B/RBP/48).

97 See *Competition Policy and Joint Ventures*.

Chapter VI

POLICY FRAMEWORK RELATING TO ACQUISITIONS OF CONTROL

A. General framework

80. A wide range of government policies directly or indirectly affect competition in general and acquisitions of control in particular. These can include policies towards foreign trade, foreign investment, industry and structural adjustment, deregulation, privatization, consumer protection, and financial market and firm structures. There is a need for consistency and coherence between those policies and competition law, taking into account the specific objectives of each type of policy and the desirability of competition law being administered in an impartial and independent manner. There is also a need for consistency and neutrality in the application of competition law towards different types of restrictive business practices and acquisitions of control, taking into account the specific effects of each type.

81. The benefits to local producers of regulatory barriers against imports would need to be weighed against the potential advantages for local consumers of trade liberalization. VERs can in fact reduce competition in both exporting and importing countries by encouraging cartelisation on the exporting side and heightening entry barriers on the importing side. To the extent that imports are restricted, the need to preserve competitive market structures within the country is even greater. On the other hand, it may also happen that the benefits of international trade liberalization are reduced by the anti-competitive conduct of private firms, requiring corrective action by Governments; competition law would then act as a complement to trade liberalization. Trade and competition policies may of course aim at different objectives. Thus, in a decision in the United States on an appeal from an anti-dumping case decided by the International Trade Commission, the court overruled the finding that steel imports from Argentina did not injure or threaten injury to the United States industry, rejecting an analysis which had taken into account the presence or absence of barriers to entry of other imports.[98] While such barriers would be relevant in looking at "injury to competition", the anti-dumping statute was concerned with "injury to industry". The statute reflected the legislative judgement that injury to the domestic industry might be severe enough to justify relief even if the economy as a whole might be better served without such relief. In-depth study of the relationships and trade-offs between competition and trade could help to clarify such questions for developing countries.

82. Whether the policy decision taken is to favour producers or consumers, it would appear advisable to maintain a certain degree of consistency. In the United Kingdom, where an investigation by the Office of Fair Trading of the domestic soda-ash industry led to the relaxation of anti-competitive contract terms with a view to opening the market to foreign competition, it has been suggested that the later imposition of anti-dumping duties on soda-ash from the United States by the European Commission may be linked to the fact that the Commission subsequently had to investigate a suspected cartel within the Community's highly concentrated soda-ash industry.[99] A *Financial Times* editorial has suggested that there is an inconsistency between demands made during the Structural Impedinant Initiative (SII) talks that cartels in Japan be eliminated and arrangements for VERs for different imported products, as well as market share targets for semiconductor exports, which may necessitate cartels to put them into effect.[100]

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98 See *USX Corp. v. United States International Trade Commission*, 628 F. Suppl.60.

99 See the "Annual Report of the Director-General of Fair Trading, 1988".

83. As international mergers and joint ventures are types of foreign investment, they may be subject in many countries to investment controls and performance requirements; they may also be granted incentives. In some developed countries, only investments by acquisition of either a significant minority or majority participation in a domestic enterprise are subject to foreign investment controls, and take-overs of large domestic firms are one of the types of investment requiring authorization. Restrictions on foreign investment or take-overs in specific sectors also exist in different countries, although the trend is towards liberalization (as in controls over foreign investment in the airline industry in the United States, for instance). In Canada, the agency responsible for the review of foreign investment, Investment Canada, looks at the broad question of net benefits to Canada from the investment, including the impact on competition. While the Bureau of Competition Policy advises on the assessment of this impact, the two agencies and their processes are separate and independent, and are not bound by each other's decisions.

84. Policies towards mergers cannot properly be considered in isolation from overall industrial policy and objectives. Industrial policy can favour the build-up of large firms through such means as concessional credit (see the annex on the experiences of the Republic of Korea). Tax or other incentives, licensing requirements and other policies may bias firms towards either internal greenfield investment or external expansion (i.e. mergers) or joint ventures, thus distorting the economic rationale for business decisions. On the other hand, industrial policies which promote SMEs or provide them with venture capital can reduce the incentive for them to seek mergers or joint ventures (although research and development policies often do promote joint ventures). Conversely, by reducing the market power of larger firms, such policies can reduce the need for competition controls on mergers and joint ventures entered into by them. Structural adjustment policies may exempt certain industrial sectors from the application of competition law in order to allow them to rationalize production and to revive the health of industries by, *inter alia*, resorting to mergers and cartels. Flexibility would be necessary so as not to impede economic development and efficiency goals, but it may be noted that, although every country exempts certain sectors from competition, competition law can only operate properly if most of the economy is subject to it. In a growing number of countries, even conduct by public sector firms comes under competition law scrutiny.

85. The reduction of state intervention (through deregulation, privatization or other means) requires action to ensure that collusive practices and restrictions imposed by private firms do not take the place of regulation. Regulated regional transport monopolies, for instance, might be replaced by territorial allocation arrangements between private transport contractors, while price control by public authorities aiming to keep prices down might be replaced by price-fixing arrangements between private firms aiming to keep prices up. The removal of entry barriers implicit in much deregulation can in fact lead to mergers and joint ventures, as in the airline industry in the United States, or the telecommunications industry in Europe. In such circumstances, it would be necessary for competition law to be applied to ensure that deregulation achieves its ultimate objective of benefiting competition and consumer welfare. Again, an in-depth study of the relationships between competition and deregulation, including privatization could help clarify these questions for developing countries.

86. Competition law and consumer protection are basically complementary. Competition law stimulates competition to the ultimate benefit of the consumer in terms of price, variety and quality, while consumer protection policy, *inter alia*, controls prices or provides consumers with the information and the redress mechanisms to ensure that the competitive process works effectively. It may sometimes happen, however, that competition and consumer protection policies conflict. Necessary licensing or prudential controls can restrict market entry, for instance, while resale price maintenance can sometimes be for the benefit of consumers. In such cases, a cost/benefit analysis would be necessary. It is for these reasons that competition law and consumer protection policy are administered by the same authorities in some countries. Similar considerations would apply in relation to policies on unfair competition.

87. Legislation or guidelines governing the allocation of bank credit, the functioning of stock markets, and the type, constitution, share structure and decision-making process of firms all determine the ease with which mergers can be executed, but may also influence merger policy. Difficulties in disciplining management may have necessitated more lenient treatment of mergers in

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100 See "Assault on Japan", *Financial Times*, 10 June 1991.

the United States and the United Kingdom. The disparity between the ease with which take-overs can be executed in the United Kingdom, and the relative difficulty in some other European countries, has led to suggestions that British competition law could be used as a lever to induce reciprocity.[101] Initiatives are being taken by the European Commission to reduce barriers to take-overs within the Community. In some developing countries, special problems may be experienced with concentration of corporate ownership. In recognition of this, the Pakistani competition law[102] provides that all undertakings with assets worth over a certain amount must be public companies, while family groups acting through individuals are not allowed to control such companies; excess shareholdings have to be sold off.

88. Competition law control of clauses in horizontal and vertical licensing, distribution and other arrangements is necessarily interrelated with enforcement policy towards mergers and joint ventures. Many practices between independent firms such as price-fixing are proscribed, or would at least be subject to screening, while the same practices in the context of an economic entity under common control would escape scrutiny. If firms are not to be encouraged to escape the regulation of such practices by joining together, consistency would require a control over mergers which is no less strict than that applied to concerted practices. Throughout the 1980s, controls over practices in licensing arrangements have been liberalised, particularly in the context of "vertical" relationships, but are often still subject to scrutiny. The possibilities for merging firms to undertake such practices amongst themselves would indicate a strong need to ensure that mergers which lead to concentration of market power genuinely lead also to pro-competitive efficiencies. Of course, market power accruing as a result of changes in market structure may not necessarily be abused while, if abuse does occur, remedies may be available. But apart from the practical difficulties of always detecting such abuse, the elimination of alternative sources of supply for the consumer, or the possibility that other firms in the market will conduct themselves in such a manner as to avoid competing too strongly with the market-dominant firm, would normally make it preferable to avoid the creation of market dominance in the first place.

89. Of course, market dominance or monopoly may arise in ways other than through acquisitions of control, through the normal competitive process or through market exit by other firms, for instance. Competition laws therefore pay attention to "static" existing concentrations of market power as well as "dynamic" situations. Competitive success is not in itself penalised, but possibilities of abuse arising from market dominance are looked at closely. In developing countries with concentrated market structures, as much if not more attention would need to be paid to existing monopolies or oligopolies as to concentration arising through acquisitions of control. However, it would be more efficient to prevent anticompetitive mergers than to order their dissolution or divestiture.

90. In the relative application of competition law towards mergers and joint ventures, it has been suggested that broadly similar economic and enforcement techniques be applied by competition authorities to such arrangements; otherwise, if more relaxed rules are applied to mergers than to research and development joint ventures, for instance, two companies may be forced to merge when a less formal agreement would better meet their needs and the economic goals of society.[103] It is therefore recommended that public policy take a neutral stance between mergers and other forms of business organization (joint ventures, licensing and greenfield investment). Even differences in the speed with which different business arrangements are considered by the competition authorities can distort the form of such arrangements. Anecdotal evidence would indicate, for instance, that firms in the European Community entering into large joint ventures attempt to structure them in such a way that they would be considered "concentrative" rather than "cooperative" ventures, thus falling under the new merger control regulations and being dealt with more speedily.[104] In other instances, firms which might have preferred simple contractual joint ventures may be induced by competition policy treatment of them to set up equity ventures. At the present

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[101] See United Kingdom Department of Trade and Industry, *Mergers Policy*, 1986.

[102] The Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance 1970.

[103] Speech delivered at Fordham University on 19 October 1990 by the Director of Investigation and Research of the Canadian Bureau of Competition Policy. Reported in the Canadian Competition Policy Record.

[104] See Council Regulation (EEC) No. 4064/89 of 21 December 1989 on the control of concentration between undertakings, and Commission Notice on the concentrative and cooperative operations under Council Regulation (EEC) No.4064/89. The distinction between the two types hinges on such factors as joint control, autonomy and the withdrawal of the parents from the relevant markets. German law also makes such a distinction, but takes into account whether an independent legal entity has been set up.

time, most categories of joint ventures apart from naked cartels are probably subjected to substantially the same economic analysis in developed countries as mergers. Yet disparities still exist in the substantive law and the administrative mechanisms applicable to different types of joint ventures.

91. Of course, there may be good reasons why differential treatment is accorded to different business arrangements. The *per se* condemnation traditionally reserved for cartels has no doubt been a major reason why joint ventures have been covered by different competition law provisions from those covering mergers. Yet some degree of cartelisation may be inherent in some types of joint ventures which still lead to efficiency. Piecemeal exceptions to the *per se* prohibition have been progressively extended to different categories of joint ventures in developed countries so as to permit case-by-case or rule-of-reason evaluations of the extent to which individual joint ventures significantly restrict competition or lead to pro-competitive efficiencies and mergers. In developing countries, joint ventures have usually been accorded favourable treatment from the outset so as to obtain the benefits of close relations with a foreign firm while maintaining the distinct identity of the local party. In many cases, however, even a minority joint venture stake has sufficed to ensure control by the foreign party. Given the vast range of equity and non-equity arrangements which can be categorised as joint ventures, as well as the differences in their anti-competitive effects and efficiencies, greater uniformity and "neutrality" in the treatment of mergers and joint ventures may not be easy to achieve. On the other hand, it may be noted that the dividing line between mergers and joint ventures is sometimes thin; interlocking share-holdings or directorates may also have similar effects as mergers or joint ventures. Further in-depth study of different types of joint ventures and interlocks would be necessary to determine such questions. The review below will mainly concentrate on competition policy towards mergers.

B. Competition rules governing mergers in developed countries

1. Overview

92. Two main trends can be discerned in merger control in developed coutries in recent years. A number of countries and the European Community have adopted merger control laws for the first time, although to some extent they may already have been applying to mergers their competition law relating to abuses of dominant position and monopolies. These countries include Belgium, Finland, Italy, Norway, Portugal, Spain, Sweden and Switzerland. Other countries have made important changes to their competition laws or enforcement policies relating to mergers, substantially liberalizing controls upon mergers by applying an economic analysis to their probable effects. The analysis currently applied in some countries is reviewed below. Differences of nuance exist in the enforcement policies of different countries but, by and large, the similarities are more important than the differences. The treatment of mergers with international effects, and cooperation agreements, will also be referred to.

2. Relevant market

93. In defining the relevant product and geographical markets, account is generally taken of reasonable possibilities for consumers to switch to other producers or goods, or for other producers to supply substitutes or to switch to producing the good in question. Depending upon the circumstances, the geographical market can vary from a small locality to the whole country or even the whole world, i.e. account is taken of both existing competition from imported goods and the possibilities for foreign firms to increase their exports to the country concerned in response to an attempt to exercise market power by merging firms. However, while the German enforcement guidelines consider that the market position of present foreign competitors has "to be determined

on the basis of their actual domestic shipments or sales" and that "potential foreign competition as a rule is of very limited importance to domestic markets because the likelihood of market entry cannot be established with sufficient certainty",[105] in the United States, "existing foreign competitors are not excluded from a relevant market solely because their sales in the United States are subject to quotas or other governmentally-imposed trade restrictions ... because it is difficult to assess the effectiveness or longevity of such restraints and to measure the likely offsetting supply responses";[106] the restraint in question has to be "effective" and "binding".

94. The German enforcement guidelines make no reference to competition in overseas markets, but the Federal Minister for Economic Affairs has to authorise a merger if its restraint of competition is outweighed by advantages to the whole economy from the merger or if it is justified by a predominating public interest; in this respect, the competitiveness of the participating enterprises outside the area of application of the Act also has to be taken into account. But the authorization may only be given if the extent of the restraint does not endanger the market economy system.[107] There is no equivalent provision in the United States law or enforcement policy in respect of mergers, although the promotion of international competiveness is accepted as a pro-competitive element in respect of research and development joint ventures.[108] In the United Kingdom, the Fair Trading Commission has to have regard to the effects of a merger in "maintaining and promoting competitive activity in overseas markets by United Kingdom firms.[109] (The Tebbitt guidelines[110] also include as a relevant criterion "the extent of competition in the home market from non-United Kingdom sources"). However, such "national champion" arguments are viewed with some caution; larger size is not assumed to lead necessarily to greater efficiency and international competitiveness.[111]

95. It is in Canada where the impact of foreign competition is taken into account most explicitly[112] and it is provided that, in the evaluation of a merger's anti-competitive effects, the extent to which there is likely to be significant competition from foreign firms should be taken into account. Mergers have to be allowed if they bring about gains in efficiency that will be greater than and will offset the effects of any prevention or lessening of competition, which gains would not otherwise be attained; it must be considered if such gains will result in a significant increase in the real value of exports or substitution of domestic for imported products. Indeed, the main objectives of the Act are specified to be the promotion of the efficiency and adaptability of the Canadian economy, the expansion of opportunities for Canadian participation in world markets while at the same time recognising the role of foreign competition in Canada, ensuring that SMEs have an equitable opportunity to participate in the Canadian economy, and lastly, the provision to consumers of competitive prices and product choices. The Canadian enforcement guidelines[113] note that the assessment of foreign competition is particularly important in the context of the globalization of markets, the continuing growth in foreign direct investment and strategic alliances in Canada, the free trade agreement with the United States, the rationalization of European industry facilitated by European Community integration and vigorous competition from firms in newly industrialized countries.

96. The effects of regional integration are also taken into account in determining the relevant market. The new EEC merger control regulation accepts that the dismantling of internal frontiers within the Community will continue to result in major corporate re-organizations, particularly in the form of concentrations, and that this is to be welcomed as being required for dynamic competition and capable of increasing the competitiveness of European industry. In evaluating a concentration, the Commission has to take into account actual or potential competition from

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[105] See "Marktbeherrschung in der Fusion Kontrolle: Checklist for Merger Control Procedures", paragraph 7 (1990). See also the 1985/86 Activity Report of the Federal Cartel Office, paragraphs 2 and 6.

[106] See "US Department of Justice Antitrust Enforcement Guidelines for International Operations" of 10 November 1988, paragraph 3323. See also the Merger Guidelines of 1984.

[107] See section 24 (3) of the Act against Restraints of Competition of 27 July 1957.

[108] See the National Co-operative Research Act of 1984.

[109] See Section 84 of the Fair Trading Act 1973.

[110] See the (United Kingdom) House of Commons written answer by the Secretary of State for Trade and Industry, of 5 July 1984.

[111] See "Annual Report of the Director-General of Fair Trading 1988.

[112] See the Competition Act of 1986.

[113] See "Merger Enforcement Guidelines", Director of Investigation and Research, March 1991.

undertakings located within or outside the Community. It has been stated that while, where there are world markets for some products or services, account will be taken of the competition brought to the Community by companies situated outside it, a competitive world market will not justify a dominant position within the Community; companies would be competitive abroad only if they are used to competing in the Community market.[114] In the United Kingdom, enforcement policy takes into account the Community integration process, and where product markets are genuinely and entirely open to international competition, major horizontal mergers may be allowed.[115] But this might not be so in respect of markets which continue to be segregated. In Australia, which has a free trade agreement with New Zealand, a court decision relating to a merger between two companies with monopoly positions in producing newsprint in each country held that the relevant market for determining dominance was both countries; a relevant factor was the fact that the merger would strengthen the international competitiveness of the companies concerned.[116]

3. Criteria relating to effects upon market concentration

97. The basic test for determining harm to competition varies from the substantial lessening of competition or tendency to create a monopoly (as in the United States) to the creation or strengthening of market domination if not outweighed by competitive advantages (as in Germany) to a broad public interest test (as in the United Kingdom), in which competition is but one though an important element among others such as effects upon trade, competitiveness of national enterprises, employment, environment or regional policy. Each approach may involve a trade-off between flexibility or certainity. In countries with a public interest criterion, there appears to be a trend towards greater weight being attached to competition rather than other factors. In the United Kingdom, for instance, the Tebbitt Guidelines clarify that mergers will be challenged mainly, but not exclusively, upon competition grounds. But the differences among these different criteria are in any event not clear-cut; in Germany, as noted above, decisions of the Federal Cartel Office may be overridden upon public interest grounds, as evidenced, for example, by the famous Daimler-Benz/MBB merger.

98. A number of different absolute size and/or market share criteria (including world market share) are applied in deciding whether or not to investigate a merger, or in relation to pre- or post-notification requirements. But such criteria are only a starting-point, and a number of other factors, such as ease of market entry, are taken into account in determining whether market dominance is likely to arise (see paragraph 97 above). Vertical and conglomerate mergers are much less likely to be challenged than horizontal mergers, but there may be differences of degree in this respect between enforcement policies in the United States, which may be more lenient, and those in some other jurisdictions. It may be noted that, in general, enforcement policies in the United States have become slightly stricter in the last few years after earlier substantial liberalization, but the difference is not great. However, enforcement policies in some states in the United States are stricter than at the federal level,[117] while the courts have taken an independent line, being sometimes more lenient or stricter towards mergers than federal enforcement policy.[118]

99. In some countries, the application of competition law may, in the decision as to whether or not to investigate or forbid a merger, take account of the fact that the acquirer is a foreign firm, although the fact of foreign ownership would not in itself be a reason *per se* for disallowing mergers.[119] However, this is not the case in the United States.[120] A separate review process is used for acquisitions by foreign companies of local companies possibly raising security concerns. In

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[114] See Sir Leon Brittan, "The Law and Policy of Merger Control in the EEC," *European Law Review*, October 1990, p.353.

[115] See "Annual Report of the Director-General of Fair Trading, 1988".

[116] See report on "The 3rd Conference on Antitrust Policies in the Asian and Oceanian countries", Economic Planning Board, Republic of Korea, 1989, pp.51-52.

[117] See "Why States are stepping up attacks on large mergers", *Mergers and Acquisitions*, July/August, 1990; and M. Blechman "The Institutional framework for merger control", in *Competition and Economic Development*.

[118] See "US courts slow down the Reagan-Bush anti-trust revolution", *Financial Times*, 5 October 1989.

[119] See *International Mergers and Competition Policy*, OECD, Paris, 1988, p.18.

[120] See *Copperweld Corp. v. Imetal*, 403 F. Supp. 579, 608; W.D. Pa., 1975.

Australia although the criteria applied are the same, a different set of procedures and remedies is used when the parents of foreign controlled firms established in Australia merge overseas; in such instances, if the Trade Practices Tribunal declares that the merger results in dominance of a substantial market in Australia and no public benefit results, the domestic subsidiary has six months to cease operations (which may be extended up to one year). Mergers among enterprises from different developed countries fall within the ambit of OECD instruments providing for non-discrimination against non-resident firms[121] and national treatment for foreign controlled firms[122], subject to different reservations made thereto. The EEC merger control regulation also provides for the possibility for negotiations between the Commission and non-member countries with a view to obtaining treatment for Community undertakings as regards concentrations in that country comparable to that granted by the Community to undertakings from that country.

4. Efficiency considerations

100. The weight attached to competitive efficiencies is bound up to some extent with the question of competitiveness in international markets, as indicated above. It is accepted in most countries that efficiency is relevant. The differences mainly pertain to the weight ascribed to them *vis-à-vis* anti-competitive effects and to whether they are taken into account as a matter of law, of enforcement policy, or of a political review process. Thus, the German enforcement guidelines make no mention of efficiency gains, but the political review process would appear to include such considerations (the decisions of the Federal Cartel office are rarely overridden). In countries using the public interest test to evaluate a merger, efficiency would be one of the criteria taken into account. Thus, in the United Kingdom, the Fair Trading Commission has to have regard, *inter alia*, to the effects of a merger in "promoting through competition the reduction of costs and the development and use of new techniques and new products" (see section 84 of the Fair Trading Act 1973).

101. In the United States, the Department of Justice " ... generally will not challenge a merger if the parties can establish by clear and convincing evidence that the merger would result in significant procompetitive efficiencies that could not be achieved except through the merger and that the merger would therefore not likely result in a net decrease in consumer welfare. The parties must establish a proportionately greater level of expected net efficiencies as the competitive risks of the merger increase".[123] On the other hand, the new EEC merger regulations allow the development of "technical and economic progress" to be taken into account "provided it is to consumers' advantage and does not form an obstacle to competition". It has been stated that such progress is not a legitimate defence for a merger which creates a dominant position; in any event, economic progress could not exist in an uncompetitive market since it would be confined to the dominant company itself.[124]

5. Overseas effects of domestic acquisitions of control

102. Despite the existence of jurisdiction over domestic enterprises and despite account being taken of their competitiveness in overseas markets, most countries, as a matter of policy, only control market structures or conduct which produce anticompetitive effects on the domestic market, and make no attempt to deal with any adverse effects on the import trade or domestic markets of foreign countries. Specific statutory exemptions from the application of competition law are provided to export cartels in several countries. "Spillover" effects of export cartels upon competition in domestic markets would usually be subject to scrutiny. In some countries, the exemption only applies if formal notification or registration of the export agreement is made to the competi-

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[121] OECD Code of Liberalization of Capital Movements.

[122] Code on National Treatment for Foreign Controlled Enterprises, 1985.

[123] See the "US Department of Justice Antitrust Enforcement Guidelines for International Operations", paragraph 3.3222.

[124] See Sir Leon Britton, *op.cit.*

tion authorities. Otherwise, the permissibility of the cartel would be evaluated under the general competition law. Confidentiality is usually maintained regarding cartels even if they have been notified or registered.

103. In Germany, even pure export cartels have to be notified to the authorities if at least one of the participants is a German firm. No authorization may be granted by the Federal Cartel Office to export cartels if they violate the principles concerning trade in goods and commercial services accepted by Germany in international treaties, or if they lead to a substantial restraint of competition within the domestic market, and there is an overriding interest in preserving competition.[125] In the United States, export arrangements, associations or companies are exempted under the general antitrust law[126], or under special registration[127] or certification[128] procedures, provided that there is no substantial "spill-over" onto domestic or import markets, artificial short supplies of the product in question are not created on domestic market, the exporting activities of a United States person are not affected, the exports are not re-imported, and the United States Government is not funding the export in question.

104. In response to attempts by the United States to obtain evidence to serve process or to enforce judgements in antitrust cases relating to conduct occurring overseas having anti-competitive effects on the United States market, several developed countries have adopted "blocking" statutes providing the authority to prevent such attempts within their jurisdictions (although little use has been made of such blocking statutes in cases relating to mergers). Conversely, they have authorised the establishment of import cartels to countervail the market power of exporting associations in the United States.

105. The fact that production is being more and more undertaken on an international scale suggests that "spill-over" onto domestic markets is likely to happen increasingly often, as production inputs exported from different countries are used for manufacture in other countries and then come back in finished form. But competition law enforcement has yet to get fully to grips with such issues. It may be recalled that the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices (paragraph C.1) provides that "appropriate action should be taken in a mutually reinforcing manner at national, regional and international levels to eliminate, or effectively deal with restrictive business practices, including those of transnational corporations, adversely affecting international trade, particularly that of developing countries and the economic development of these countries". It has been suggested in an OECD report[129] that Governments of developed countries: (a) should not encourage the creation of export cartels but should ensure that their policies are at least neutral in respect of the formation of such cartels; (b) should consider requiring notification to themselves of export cartels involving national firms (as is already done in some countries); and (c) should be ready to cooperate, as far as their laws permit, with the competition authorities of other developed countries in any investigation into possible anti-competitive effects of such arrangements located in their countries. Developing countries should also have the possibility of benefiting from such measures, and cooperation could also extend to mergers. The Restrictive Business Practices Set would be an appropriate instrument for cooperation between developed and developing countries in this area.

6. Domestic effects of overseas acquisitions of control

106. Under the principle of territoriality, all developed countries apply their laws to conduct that takes place within their national territory, regardless of the nationality of the persons involved. "Objective" territorial jurisdiction can also exist where an act starts abroad and ends in national

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125 Section 6 (3) of the Act against Restraints of Competition. The decision may be overridden by the Minister for Economic Affairs.

126 See the Foreign Trade Antitrust Improvement Act of 1982, section 2.

127 See the Webb Pomerene Act of 1918. The Act only applies to goods, and prohibits "unfair methods of competition" by the association overseas.

128 See the Export Trading Company Act of 1982. The Act only grants immunity from government suit and treble damages.

129 See *Competition and Trade Policies - Their Interaction*.

territory, and national law would then be applied to the act abroad, as long as it can be linked directly to the act within national territory. In addition, the concept of "enterprise unity" has been used in some countries to establish in *personam* jurisdiction over foreign-based parents where they exercise the requisite degree of control over local affiliates.[130] Enterprise unity has also been applied in some countries to hold domestic parents or subsidiaries responsible for the conduct of their affiliates abroad.[131] Objections to this have sometimes been encountered from countries adhering to the territoriality principle. Other controversies have arisen from the application of United States law providing that actions by American companies abroad would, in accordance with the nationality principle, fall within American jurisdiction; the main question has been the definition of the nationality of foreign subsidiaries of American firms.

107. However, the main controversies have arisen with respect to the application of the "effects doctrine". American jurisdiction has often been asserted with respect to alleged anti-competitive practices by foreign parties abroad having effects on the American market or trade. Thus, competition law has been applied to import cartels set up overseas to countervail the market power of Webb-Pomerene associations set up in the United States.[132] It has even been held that the President of the United States has no authority to grant antitrust immunity to foreign firms undertaking VERs at the request of the American Government.[133] However, the effects doctrine has not often been applied to mergers of foreign companies. When two Swiss pharmaceutical companies exporting to the United States merged, an initial attempt was made to prevent the merger, but eventually the divestment of their American subsidiaries was accepted.[134] The attempted take-over by a Luxembourg company controlled by South African interests of a British firm was reviewed and not opposed by the competition authorities of the United States, the European Community, the United Kingdom and Australia, but was prevented through a private antitrust action in the United States.[135] (There were substantial assets in the United States.)

108. The application of the "effects doctrine" is tempered by "comity" considerations which lead to a balancing of relative national and foreign interests, or a limited abstention of exercise of jurisdiction based on diplomatic suggestions and considerations.[136] However, there are ambiguities and discrepancies in the relevant case law, and the balancing test has been criticized *inter alia* for raising issues beyond judicial competence, such as the weighing of domestic *vis-à-vis* foreign interests. The Department of Justice's enforcement policy (under the 1988 Guidelines) is to consider whether significant interests of any foreign sovereign would be affected and to assert jurisdiction only when it is concluded that it would be reasonable to do so, taking into account, *inter alia*, whether effective relief could be obtained. This would not of course deter private action, as in the Minorco case; private suits constitute the bulk of antitrust cases in the United States. Other tempering factors include the sovereign immunity,[137] and Act of State defences (the latter defense has been used, for example, in a private action brought against OPEC in respect of oil price increases),[138] as well as the foreign sovereign compulsion defense (encouragement or acquiescence will not suffice). It is interesting to note that the latter defense has been used as a means of immunizing foreign exporters undertaking VERs from private antitrust suits; once foreign Governments have legally compelled their exporters to undertake VERs, "comfort letters" have been issued by the United States Attorney-General to confirm that the VERs would therefore not violate antitrust law. On the other hand, trade legislation provides that trade action can be taken against any goods from a State that injures international trading interests by the purposeful non-enforcement of its anti-trust laws.[139]

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[130] See for example the *Dyestuffs* case decided by the European Commission.

[131] See for example the United States Supreme Court case of *Continental Ore Co. v. Union Carbide and Carbon Co.* 370 U.S. 690 (1962).

[132] See *Daishowa International v. North Coast Export Co.* 1982-2 Trade Cas. (CCH) 64, 774 (1982).

[133] See *Consumers' Union of United States Inc. v. Rogers*, 352 F. Supp. 1319 (D.D.C. 1973).

[134] See *United States v. CIBA Corp.* (1970) Trade Cas. (CCH) 73, 269 (S.D.N.Y. 1970).

[135] See *Consolidated Gold Fields PLC v. Minorco, S.A.* 871 F. 2d 253 (2d Cir.1989).

[136] See, in particular, *Timberlane Lumber Co. v. Bank of America*, 549 F. 2d 597 (9th Cir. 1976) and *Mannington Mills v. Congoleum Corp.*, 595 F. 2d 1287 (3rd Cir. 1979).

[137] See the Foreign Sovereign Immunities Act of 1976.

[138] See International Association of Machinists v. The Organization of the Petroleum Exporting Countries 649 F. 2d 1354 ((Cir. 1981).

[139] See section 30 of the Omnibus Trading and Competitiveness Act of 1988.

109. A limited degree of extra-territoriality also exists under the Australian Trade Practices Act. In Germany, although the "effects" principle is also applied in antitrust cases, its application is qualified by the public international law principle of non-interference. In respect of take-overs of foreign companies abroad by subsidiaries ultimately owned by German companies, it has been held that these are subject to pre-notification requirements,[140] but mergers themselves will not be blocked if the "centre of gravity" of the transaction is outside Germany and the effects on the German market are small;[141] if the effects on the German market are significant, only that part of the merger having domestic effects (i.e. the merger of the local subsidiaries) will be prohibited.[142] In the European Community, the "objective territoriality" principle has been applied to assert jurisdiction over any cartels, joint ventures or mergers affecting competition within the Common Market, as in the famous Wood Pulp case.[143] A number of large mergers among foreign companies have already been screened under the new Merger Regulation.

110. Because of these jurisdictional claims, several mergers or joint ventures have required approval by more than one competition authority. Thus, two joint ventures between an American firm and a Swedish/Swiss firm in the power generation business were reviewed by both the American and Canadian authorities, giving rise to a divestment order in the United States[144] and a commitment by the firms in Canada to seek tariff remission and reduction for the relevant products, so as to reduce barriers to entry for foreign competition. A merger between two American firms led to a divestment order being made in respect of a British subsidiary by the Monopolies and Mergers Commission,[145] even though the merger had been cleared in the United States. Most notably, a merger between two major razor and razor blade companies has been reviewed by six merger control authorities (including those of the United States, the United Kingdom, the European Commission, and Germany). A divestment order has been made in the United Kingdom[146] and a rescission enforced in respect of the United States part of the transaction.[147] Such multiple merger reviews may lead to inconsistent substantive results, given the different competitive effects in different jurisdictions. Procedural problems also arise, particularly with respect to multiple and differing pre-notification requirements and deadlines. It is clear that in a world where markets have become increasingly interdependent, where enterprise transactions increasingly cross national borders, and where more competition laws have been and are being adopted, more and more Governments will seek to claim concurrent jurisdiction over a single transaction, and their analyses and interests can diverge. There may be controversy among different Governments, involving the use of blocking statutes and diplomatic disputes. Such a climate would hardly enhance security and predictability for enterprises.

111. In fact, as noted above, controversies have already arisen in the past, mainly with respect to assertions of procedural jurisdiction by the United States. Such controversies have died down as a result of greater attention to comity considerations, the liberalization of antitrust enforcement and cooperation undertaken by competition authorities. However, since comity is considered in most countries to be a non-legal and discretionary standard, not preventing States from exercising their legal jurisdiction whenever their own interests are materially affected, it cannot by itself suffice to avoid conflicts; in particular, comity would hardly deter the initiation of private suits. Nor can comity suffice to meet the challenges arising from the globalisation of the world economy, which require more positive cooperation and coordination by competition authorities.

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140 See the Organic Pigments case.

141 See the Bayer/Firestone case KG Nr. 26 1980 WuW/E OLG, 2419 (Synthetischer Kautschuk II).

142 See the Philip Morris/Rothmans case, 29 October 1985, WuW 6/1986, pp.481-495.

143 See *Ahlström et al. v. European Commission*, (1988) ECR 5193, (1988) 4 C.M.L.R. 901).

144 See *United States v. Westinghouse Electric Corp.* 1989-1 Trade Case. (CCH) 68 607 (S.D.N.Y. 9 May 1989).

145 See *Mitek/Gang Nail*, 1988, C.429.

146 See Department of Trade and Industry press notice of 21 March 1991.

147 See *United States v. Gillette Co.*, 1990-2 Trade Cas (CCH) 69, 142 (D.D.C. 25 July, 1980).

7. *Cooperation*

112. A number of bilateral and plurilateral cooperation agreements dealing with competition have been entered into by developed countries. The United States has entered into agreements with Australia, Canada and Germany, and is discussing a possible agreement with the European Community. Germany also has an agreement with France. The EFTA countries cooperate amongst themselves in this area, and individual EFTA members also have cooperation agreements with the European Community. The OECD has also dealt with the subject.[148] These agreements, with some exceptions provide for notification of investigations affecting important interests of other countries party to the agreement, consultations, the taking into account of the other parties' significant interests, the supply of relevant information and coordinated action in respect of the same anti-competitive practice. The OECD resolution provides that member countries should use moderation and self-restraint and take into account foreign substantive laws and procedural rules in undertaking investigations abroad. It is also provided that a member country which agrees that enterprises situated in its territory are engaged in restrictive business practices harmful to the interests of the country requesting consultations should attempt to ensure that these enterprises take remedial action, or should itself take whatever remedial action as appropriate in accordance with its legislation, on a voluntary basis and considering its legitimate interests. The OECD resolution and the EEC/EFTA country agreements provide for a conciliation mechanism in case of disputes. The EFTA Convention goes further in allowing any disagreements to be referred to the EFTA council for a decision by majority vote, after an "examining committee" has considered the matter.[149]

113. In practice, it is only the notification and consultation parts of all these agreements which have been properly applied. Information exchange has been hampered by considerations of confidentiality. In any event, competition authorities would often have no knowledge of transactions having effects solely outside the country. A number of approaches are being mentioned to take things further, including: increased information sharing; improved mechanisms for obtaining information from private parties in foreign countries; the harmonization of information requirements; allocation of jurisdiction over individual mergers to particular national authorities in accordance with their relative interests and the assets within their territory, with resort if necessary to a dispute-settlement mechanism; harmonization of substantive merger law and enforcement policy; and even an international merger control regime.[150] It has been suggested that "the appearance of global firms and the strategic alliances they are concluding may lead to new world competition", calling for "a systematic assessment of national competition policies and their differences leading to multilaterally agreed harmonization of rules and the way in which they are applied".[151] Discussions on such approaches have not proceeded very far, particularly as some of them would obviously be difficult to realise for the time being. Yet an ongoing debate has been engaged which should gradually lead to strengthened cooperation.

C. Competition rules covering mergers in developing countries

114. A number of developing countries from all regions[152] have adopted competition laws, some of them dealing specifically with mergers and others applying indirectly to mergers through provisions against abuse of dominant positions, monopolies, or impediments against free competition.

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[148] The latest OECD resolution is the Revised Recommendation of the Council concerning cooperation between Member countries on restrictive business practices affecting international trade of 21 May 1986.

[149] See articles 15 and 31 of the EFTA Convention.

[150] See the address given by Mr. Stark of the United States Department of Justice before the Fordham Law Institute on 18 October 1990.

[151] See P. Montigny, "From technological advance to economic progress", *OECD Observer*, June/July 1991.

[152] Such countries include Argentina, Brazil, Chile, Côte d'Ivoire, Gabon, Kenya, India, Pakistan, Republic of Korea, Sri Lanka and Thailand. Several other countries are considering the adoption of competition laws.

[153] Law No.4137 of 10 September 1962 concerning the suppression of abuses of economic power. See also Decree No. 52025 of 20 May 1963 containing the regulations given effect to the law.

Some of these laws are quite old: Brazil's law for instance, dates back to 1962,[153] while India's dates back to 1969[154] and Pakistan's to 1971.[155] Others are quite recent, such as Gabon's 1989 law,[156] Kenya's 1988 law,[157] or Sri Lanka's 1987 law.[158] Some common elements and differences can be distinguished in the treatment of mergers in these laws.

115. The Brazilian law deals with mergers in the context of controls on abuse of economic power, but the existence of abuse is assessed in structural terms; the control of Brazilian markets or the elimination of competition is in itself an abuse, which can arise *inter alia* through mergers, the association of companies and interlocking directorates. Once an abuse is established, it is subject to an outright prohibition. In India, the emphasis is upon the avoidance of concentration of economic power to the common detriment, with particular attention being paid to what are known as MRTP companies, possessing assets of a certain worth or producing 25 per cent of output of a particular item. Size or market dominance is assessed in relation not only to individual firms, but to membership in a group of "interconnected undertakings". Interlocking directorates are also controlled. However, very recently there has been a substantial liberalization. Similar attention is paid to "associated undertakings" in Pakistan; the creation or maintenance of any relationship between competing firms having at least one-third market share between them which provides one of the owners or partners with at least one-third control of the other firm constitutes "unreasonable monopoly power". Such power can also arise where an acquisition or merger is likely to create monopoly power or to substantially lessen competition is any market.

116. However, the Pakistani law provides for a balancing of any monopoly power created against any efficiencies arising in production, distribution, services, technical progress or exportation, if these could not have been achieved by less anti-competitive means and if they clearly outweigh the absence or lessening of competition. A similar balancing test is applied in Sri Lanka. There is a general prohibition against monopoly situations or mergers exceeding a prescribed market share or giving rise to control or dominance of the market (attention is again paid to interconnected bodies), but monopolies or mergers may be authorized if they are not likely to operate against the public interest. Similarly, in Kenya, a merger may be permitted if it will lead to efficiencies resulting in better competitiveness *vis-à-vis* imports or in export trade, thereby increasing employment, but account will also be taken of whether it reduces competition in domestic markets, increases the ability of oligopolistic producers to manipulate domestic prices, or encourages capital-intensive rather than labour-intensive technology. In Kenya, only horizontal mergers are controlled (as in some other developing countries), but existing vertical concentration of economic power may be investigated.

117. A number of issues or problems have arisen in different countries in the implementation of competition law. A fundamental question is the appropriate balance between ensuring more competition and achieving greater economic efficiency.[159] This has manifested itself not only at the level of individual cases but in general government policy. Indeed the two are interrelated, since the latter sets the framework for the former; ambiguities in government policy and lack of clear guidelines have hampered decision-making in competition cases. Where it is the responsibility of government ministries to refer individual cases to competition authorities, efficiency considerations, as well as political bias, have in some countries led to inconsistent action being taken. A separate question has been the applicability of competition law to public sector enterprises; there is such applicability under Chilean law, and it has been suggested that this should also be the case in other countries.

118. Another problem has been the lack of public awareness of what competition entails. In some countries, collusion and other restrictive business practices have become entrenched business habits, especially in the context of the vacuum left by deregulation. Moreover, in dealings with foreign suppliers using restrictive business practices, those primarily affected do not even realise

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[154] The Monopolies and Restrictive Trade Practices Act 1969.

[155] The Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance 1971.

[156] Loi No. 5/89 relative à la concurrence du 6 juillet 1989.

[157] The Restrictive Trade Practices, Monopolies and Price Control Act 1988.

[158] The Fair Trading Commission Act, No.1 of 1987.

[159] See "Control in India of restrictive business practices", (UNCTAD/ST/MD/20), consultant study prepared by Mr. H. K. Paranjape. See also "Corporate Behaviour in restraint of trade of goods and services in Pakistan".

what is going on, or do not know that there are recourse procedures available.[160] Painstaking pedagogical efforts have been made to correct this situation in Chile. Effective application of competition law in developing countries clearly depends to a large extent upon such pedagogical efforts. A related question is allowing private recourse to the courts in competition cases. This is allowed in Kenya, for instance, but misgivings have been expressed about possible misuse of this right by competitors.[161] Other problems in different countries have included: difficulties in delineating the relevant market, market shares and company assets in the absence of available, reliable, or disaggregated economic or product data or company accounts, and of enough staff with the requisite skills; difficulties in proving that firms are really interconnected; difficulties in gathering evidence and insufficient investigatory powers; and delays arising from appeals to the courts, as well as judicial misunderstandings of the reasoning applied.

119. As regards TNCs, the law has been applied to their subsidiaries in appropriate cases, but little attempt has been made to reach parents overseas. It is likely that wider adoption and more effective implementation by developing countries of competition laws will affect local TNC subsidiaries more often, and will also lead to more attempts to obtain information about TNCs overseas by competition authorities of developing countries. Attempts to obtain information from TNC parent companies, affiliates in other countries and other parties overseas are also likely to be more frequent. It would therefore appear essential that bilateral and multilateral consultations and cooperation among competition authorities of developed and developing countries be strengthened, along the lines already well practised among the competition authorities of developed countries. It would appear necessary that developing countries should provide their contribution to the ongoing debate and search for new avenues of cooperation. The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices would be an appropriate instrument for stronger consultations and cooperation.

120. However, for individual developing countries to participate in this process, it would be essential for them to adopt and/or effectively apply competition laws in general, and merger control laws in particular, as well as to ensure that such laws are up-to-date and in tune with both the specific competitive conditions in their markets and the current world environment. Cooperation from other countries would assist the developing countries to undertake the necessary reforms.

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[160] See W. Latapiat, "Preventing collusion and abuse of dominant positions: the experience of Chile", in *Competition and economic development*, p.143.

[161] See S. Wainaina, *Means of Competition Law Enforcement, Symposium on Competition and Economic Development*, OECD, October 1989.

Annex

CONCENTRATION OF MARKET POWER IN THE REPUBLIC OF KOREA

The experiences of the Republic of Korea provide an interesting example of the effects of market concentration in a developing country, and of the influence of an integrated set of governmental policies. The market of the Republic of Korea is highly concentrated, with much market power residing in particular in the hands of large conglomerate business groups which are linked through family control and interlocking shareholdings (the *jaebol*). In 1987, the share of the *jaebol* in total employment and shipments were 17.6 and 37.3 per cent respectively; the disparity may be caused primarily by their capital-intensive production methods, and partially by their power to manipulate prices to some extent.[a] Recently, their share of total shipments has tended to increase, while that of total employment has generally decreased. The proportion of product markets in which a *jaebol* is ranked at least third in market share is high, amounting in 1987 to 62.3 per cent of the total number of markets in which they participated. In 1988, the share in manufacturing value added of the 10 largest *jaebol* was 12.5 per cent, while in 1990, the combined sales of the four largest *jaebol* amounted to more than half of the Republic of Korea's gross national product.[b] It may be noted, however, that market concentration in the Republic of Korea decreased between 1982 and 1987, because of the relatively faster growth of medium-sized firms in the general machinery and electronics industries. A key factor in this growth may have been the rapidity with which trade expanded, which would provide "breathing space" for smaller market players.

The average number of subsidiaries per *jaebol* grouping was 17.1 in 1989, the majority set up through new establishments, but many also acquired through take-overs, particularly of failing firms and public enterprises. In the decade 1981-1990, it is reported that total mergers among firms of the Republic of Korea (*jaebol* or otherwise), amounted to 2,003 (only 1,045 of which were among unaffiliated companies), and that most of these mergers were driven by government policies or financial and tax benefits, rather than by strategic considerations.[c] In the period 1981-1989, the Korean Fair Trade Commission examined 1,846 cases of "business integration", out of which 799 were through stock acquisitions, 276 through mergers, 186 through interlocking directorates and 125 through asset acquisitions.[d] The majority of these case were conglomerate arrangements in the manufacturing sector. Motives that were reported included diversification, improvement of financial structures, rationalization of production processes, upgrading of distribution systems and disintegration.

The high concentration of market power in the hands of the *jaebol* arose because of such factors as scarce entrepreneurial resources and market imperfections, necessitating concentration of entrepreneurship to obtain and utilize production inputs not fully transacted in the market and government policies emphasizing strategic industries that require a huge capacity in technology, capital, manpower and organization, and directing resources to such industries through fiscal and credit policies. Meanwhile, concentration of corporate ownership also arose because weak stock markets necessitated raising capital through debt finance rather than issuing shares to the public, as well as because of the practice of intercompany shareholdings. A business licensing system restricting the number of firms in specific industries and regulating their business activities reduced competition to the *jaebol*. The protection of domestic markets from imports and export promotion policies allowed the *jaebol* to develop economies of scale. Restrictions on foreign investment served the same purpose, and also resulted in reliance upon foreign loans as a source of capital and upon licensing and turnkey projects as sources of technology, rather than direct foreign investment.

Concentrated product markets in manufacturing in the Republic of Korea have higher profitability than competitive markets, particularly where they are highly protected, suggesting rent-

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a See "Corporate policies in Korea", consultant study prepared for the UNCTAD secretariat by Mr. Kyu Uck Lee.

b See "Time to cut giants down to size", *Financial Times*, 10 April 1991.

c Information provided by KPMG Sam Long & Co.

d "Business integration" within the meaning of the Korean Fair Trade Act includes also the establishment of new enterprises.

seeking behaviour. It may also be noted that mean price cost margins are lower in sectors with high export shares, suggesting that competition in international markets makes domestic pricing also more competitive. However, there is little evidence of other anti-competitive behaviour. Out of 293 market-dominating firms designated by the Korean Fair Trade Commission in 1990, only 10 were found to have abused their positions through false allegations about other firms, tying arrangements and predatory pricing.[e] It is of course difficult to estimate the deterrent effect of competition law. Nor has high concentration reduced the intensity of the rivalry among the *jaebol*, a factor which has certainly enhanced their competitiveness.

High concentration has led to a number of efficiency gains. It has resulted in the creation of a few firms that are competitive by world-class standards. Scarce capital resources have been brought together to attain the necessary critical mass necessary in capital-intensive industries. The reputation of the *jaebol* and the artificial inflation of each subsidiary's capital through intercompany shareholdings has facilitated capital raising. Their conglomerate structures have also enabled cross-subsidization of high risk projects. Efficient use has been made of scarce skilled personnel by rotation around a conglomerate. Production scale economies have been facilitated; the Republic of Korea's electronics industry, for example, is heavily weighted towards high volume in standardised products subject to sizeable scale economies. A high degree of integration backwards into component production has been an asset, since in-house demand is large and since security of supply of key components has been ensured. *Jaebol* subsidiaries have better bargaining power in technology transfer agreements, resulting in better terms. Efficiencies have also occured in publicity and marketing activities, including through name recognition. Substantial research and development activity has been undertaken. The *jaebol* are behind nearly 40 per cent of total investment, particularly in new technology development.[f] Thus, even in sectors where there has been deregulation, such as the life assurance industry, new market entry has not significantly reduced the dominance of some *jaebol*, due to their reputation, sales ability, efficient management and scale economies.[g]

Each of these efficiency gains mentioned above, however, has also had its corollary inefficiencies. The thin capitalization of the *jaebol*, high debts and high diversification into risky industries may have led to financial vulnerability. Internal capital allocations may be biased towards activities associated with growth rather than profits. Over-diversification may have led to capital being spread too thinly (some of the *jaebol* have in fact already started to specialize in response to competition from imports). The financial failure of one *jaebol* subsidiary risks being transmitted to the whole group through inter-company shareholdings, resulting in dangers for the whole economy. The high vertical integration of the *jaebol* may have stifled the growth of supplier networks and may no longer be appropriate under current conditions of rapid demand changes and product differentiation, where well developed supplier networks are often more efficient than internalization of component production (although more outsourcing has started to take place). The *jaebol* may lack the flexibility and innovative ability to respond to emerging opportunities in frontier technologies. As a result, it has been suggested that the pattern of advance in the Republic of Korea in high technology sectors is likely to be uneven, dependent upon a limited number of large commitments which are uncertain in their outcomes.[h] But corrective measures are being taken by the Government, as indicated in paragraph 9 below.

Vis-à-vis foreign firms, firms of the Republic of Korea have, as noted above, favoured self-reliance where possible, and this strategy has sometimes been extremely successful. In the car industry, for instance, the spectacular performance of a *jaebol* car manufacturer which relied upon its own efforts contrasts with the relatively poor performance of a car production joint venture between another *jaebol* and an American manufacturer.[i] However, the small size of the domestic

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e See "Corporate policies in Korea". Such firms are designated annually. For a firm to be considered to be in a "market-dominating position", it must have a monopolistic, duopolistic or oligopolistic position in a market with total domestic sales amounting to more than $45 million in the previous year.

f See Sung Taik Han, "Competition Policy and Economic Development in Korea", in *Competition and Economic Development*, p.223.

g See Un Hoe Park, "Trade in Insurance in Korea", in UNCTAD publication "Services in Asia and the Pacific".

h See B. Levy and Wen Jeng Kuo, "The strategic orientation of firms and the performance of Korea and Taiwan in frontier industries : lessons from comparative case studies of keyboard and personal computer assembly", *World Development*, Vol.19, No.4, pp. 363-374, 1991.

i See C. Oman, *New forms of investment in developing country industries : mining, petrochemicals, automobiles, textiles, food*", OECD Development Centre, Paris, 1989, pp.157-160.

market and accelerating technological factors have constituted handicaps to the "go-it-alone" strategy. On the other hand, although it is still too early to assess the overall results of "strategic alliances" between domestic and foreign firms in the electronics industry, it is reported that they have sometimes led to disappointing results in terms of technology transfer.

This has motivated firms in the Republic of Korea to take over a few small start-up firms in the United States for their semiconductor and computer technology, for instance, and even to undertake research and development through such firms. Other motives have included the circumvention of trade protection and the search for low wages. It is reported, for example, that the acquisition of a Canadian steel company by a steel company from the Republic of Korea in 1988 was motivated by the low price, advanced technology from the Canadian laboratories, low energy costs, ample nickel supplies, and unrestricted access to the United States market, without adding to the Republic of Korea's trade surplus.[l] Between 1986 and March 1991, a total of 35 overseas take-overs by companies from the Republic of Korea companies is reported to have taken place.[k] It remains to be seen whether financial problems of start-up firms in the United States will lead to more overseas take-overs by companies from the Republic of Korea.

The economy of the Republic of Korea has been progressively deregulated; opportunities for new entry have been expanded at the manufacturing level, competition has been promoted at the distribution stage, and a number of other regulations relaxed. More bank finance is being directed towards SMEs, while the *jaebol* have been invited to designate core activities which would receive priority in loans. Trade and foreign investment régimes have been liberalised. In the area of competition, the law aims at encouraging fair and free competition and thereby stimulating creative business activities and innovation, protecting consumers and promoting a balanced development of the national economy.[l] To this end, it forbids the abuse of market-dominating positions, restricts business integration, prohibits investment holdings and cross-investments among parent and subsidiary firms, limits the equity investments of big business groups, forbids collusive activities, prohibits unfair business practices and regulates international business contracts. Cross-holdings among subsidiaries cannot exceed 40 per cent. Business integration by firms whose equity capital or assets exceed around $1.5 or $7 million respectively is restricted if the firm may cause substantial injury to competition in any line of commerce. Exceptions may be made for business integration aimed at rationalization or strengthening of the international competitiveness of the relevant industry (separate legislation provides for special measures in "sunrise" and "sunset" industries, but these can only be applied for three years).

An interesting feature of the Act is that it requires other government authorities to consult with the Minister of the Economic Planning Board whenever it is wished to adopt any legislation or measures which might restrict competition. Of the 1,846 cases of business integration reported up to 1989, the Fair Trade Commission has issued 293 warnings for correction, two recommendations for correction, and seven orders to cease and desist (see footnote [a]). Conglomerate concentration has not so far been controlled , but will be covered in future. Separate legislation encourages SMEs to develop cooperative business relationships with larger firms and ensures the fairness of subcontracting relationships.[m]

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l See, "Uniting for the future", *Korean Business World*, February 1990, p 40.

k Information provided by KPMG San Tong & Co.

l See Monopoly and Fair Trade Act, Law No. 3320 of 31 December 1980 (as amended), Art. 1.

m The Fair Sub-contracting Act of 1985.

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Tenth session
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Item 4 (c) of the provisional agenda

CONTINUED WORK ON THE ELABORATION OF A MODEL LAW OR LAWS ON RESTRICTIVE BUSINESS PRACTICES

Revised draft of possible elements for articles of
a model law or laws and commentaries on the elements

Prepared by the UNCTAD secretariat

GE.91-51479

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Clarity of recommendations	( )	( )	( )	( )	( )
Comprehensiveness of coverage	( )	( )	( )	( )	( )

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INTRODUCTION

1. At its third session, the Intergovernmental Group of Experts on Restrictive Business Practices, in its resolution 3 (III), took note of the revised draft of the model law or laws on restrictive business practices (TD B RBP 15 Rev.1 and Corr.1 and 2), and the comments made thereon by the Group, and requested the UNCTAD secretariat to continue work on the model law, taking into account, *inter alia*, the comments made at the third session of the Group and the importance which the Group attached to the preparation of the handbook on restrictive business practices legislation.

2. At its sixth session, the Group, in its agreed decisions and conclusions, requested the UNCTAD secretariat to undertake, for the seventh session of the Group, a revision of the draft elements for the model law or laws, bearing in mind recent and continuing trends in restrictive business practices (RBPs) and their control, as indicated in the information and legislation provided to the secretariat and indicated in the comments made at the third, fifth and sixth sessions of the Intergovernmental Group of Experts.

3. Accordingly, the UNCTAD secretariat prepared a preliminary report on the revised draft elements for a model law or laws for the control of restrictive business practices (TD B RBP 48, part IV), which was presented to the seventh session of the Intergovernmental Group.

4. The Group, at its eighth session, in its agreed decisions and conclusions, called upon the UNCTAD secretariat to continue its work on the model law or laws on restrictive business practices.

5. The Secretary-General of UNCTAD, in his note of 4 June 1991 (TD 420 8 (5) Q, requested Governments and regional groupings to supply necessary information on recent and continuing trends in RBPs and their control, and any other comments on the preliminary report mentioned above, as well as on the revised draft of the model law or laws on restrictive business practices (TD B RBP 15 Rev.1).

6. The UNCTAD secretariat has prepared the present document as a second preliminary report on its continuing work on the elaboration of a model law or laws on restrictive business practices. The document is divided into two parts: Part I contains draft possible elements for articles of the model law or laws, and Part II consists of commentaries on each of the draft possible elements for the articles.

7. In order to assist and guide the secretariat in completing its task, Governments and regional groupings are requested to make comments on this report at the tenth session of the Intergovernmental Group and to supply necessary information on recent and continuing developments in the control or elimination of restrictive business practices.

PART I

DRAFT POSSIBLE ELEMENTS FOR ARTICLES

TITLE OF THE LAW :

Elimination or control of restrictive business practices

Antimonopoly Law

Competition Act

POSSIBLE ELEMENTS FOR ARTICLE 1

OBJECTIVES OR PURPOSE OF THE LAW

To control or eliminate restrictive agreements or arrangements among enterprises, or acquisition and or abuse of dominant positions of market power, which limit access to markets or otherwise unduly restrain competition, adversely affecting domestic or international trade or economic development.

POSSIBLE ELEMENTS FOR ARTICLE 2

DEFINITIONS AND SCOPE OF APPLICATION

1. Definitions

(a) "Enterprises" means firms, partnerships, corporations, companies, associations and other juridical persons, irrespective of whether created or controlled by private persons or by the state, which engage in commercial activities, and includes their branches, subsidiaries, affiliates or other entities directly or indirectly controlled by them.

(b) "Dominant position of market power" refers to a situation where an enterprise, either by itself or acting together with a few other enterprises, is in a position to control the relevant market for a particular good or service or group of goods or services.

(c) "Relevant market" refers to the line of commerce in which competition has been restrained and to the geographic area involved, defined to include all reasonably substitutable products or services, and all nearby competitors, to which consumers could turn in the near term if the restraint or abuse raised prices by a not insignificant amount.

II. Scope of application

(a) Applies to all enterprises as defined above, in regard to all their commercial agreements, actions or transactions regarding goods, services or intellectual property.

(b) Applies to all natural persons who, acting in a private capacity as owner, manager or employee of an enterprise, authorize, engage in or aid the commission of restrictive practices prohibited by the law.

(c) Does not apply to the sovereign acts of the state itself, or to those of local governments, or to acts of enterprises or natural persons which are compelled or supervised by the State or by local governments or branches of government acting within their delegated power.

POSSIBLE ELEMENTS FOR ARTICLE 3

RESTRICTIVE AGREEMENTS OR ARRANGEMENTS

I. Prohibition of the following agreements between rival or potentially rival firms, regardless of whether such agreements are written or oral, formal or informal:

(a) Agreements fixing prices or other terms of sale, including in international trade;

(b) Collusive tendering;

(c) Market or customer allocation;

(d) Restraints on production or sales, including by quota;

(e) Concerted refusals to purchase;

(f) Concerted refusal to supply;

(g) Collective denial of access to an arrangement, or association, which is crucial to competition.

II. Authorization

Practices falling within paragraph I, when properly notified in advance, and when made by firms subject to effective competition, may be authorized when competition officials conclude that the agreement as a whole will produce net public benefit.

POSSIBLE ELEMENTS FOR ARTICLE 4

ACTS OR BEHAVIOUR CONSTITUTING AN ABUSE OR ACQUISITION AND ABUSE OF A DOMINANT POSITION OF MARKET POWER

I. Prohibition of acts or behaviour involving an abuse or acquisition and abuse of a dominant position of market power

A prohibition on acts or behaviour involving an abuse or acquisition and abuse of a dominant position of market power:

(i) Where an enterprise, either by itself or acting together with a few other enterprises, is in a position to control a relevant market for a particular good or service, or groups of goods or services;

(ii) Where the acts or behaviour of a dominant enterprise limit access to a relevant market or otherwise unduly restrain competition, having or being likely to have adverse effects on trade or economic development.

II. Acts or behaviour considered as abusive:

(a) Predatory behaviour towards competitors, such as using below-cost pricing to eliminate competitors;

(b) Discriminatory (i.e. unjustifiably differentiated) pricing or terms or conditions in the supply or purchase of goods or services, including by means of the use of pricing policies in transactions between affiliated enterprises which overcharge or undercharge for goods or services purchased or supplied as compared with prices for similar or comparable transactions outside the affiliated enterprises;

(c) Fixing the prices at which goods sold can be resold, including those imported and exported;

(d) Restrictions on the importation of goods which have been legitimately marked abroad with a trademark identical with or similar to the trademark protected as to identical or similar goods in the importing country where the trademarks in question are of the same origin, i.e. belong to the same owner or are used by enterprises between which there is economic, organizational, managerial or legal interdependence, and where the purpose of such restrictions is to maintain artificially high prices;

(e) When not for ensuring the achievement of legitimate business purposes, such as quality, safety, adequate distribution or service:

(i) Partial or complete refusal to deal on an enterprise's customary commercial terms;

(ii) Making the supply of particular goods or services dependent upon the acceptance of restrictions on the distribution or manufacture of competing or other goods;

(iii) Imposing restrictions concerning where, or to whom, or in what form or quantities, goods supplied or other goods may be resold or exported;

(iv) Making the supply of particular goods or services dependent upon the purchase of other goods or services from the supplier or his designee.

(f) Mergers, takeovers, joint ventures, or other acquisitions of control, including interlocking directorships, whether of a horizontal, vertical, or a conglomerate nature, when:

(i) At least one of the enterprises is established within the country; and

(ii) The resultant market share in the country, or any substantial part of it, relating to any product or service, will result in a dominant firm or in a significant reduction of competition in a market dominated by very few firms.

III. Authorization

Acts, practices or transactions not absolutely prohibited by the law may be authorized if they are notified, as described in Article 6, before being put into effect, if all relevant facts are truthfully disclosed to competent authorities, if affected parties have an opportunity to be heard, and if it is then determined that the proposed conduct, as altered or regulated if necessary, will be consistent with the objectives of the law.

POSSIBLE ELEMENTS FOR ARTICLE 5

SOME POSSIBLE ASPECTS OF CONSUMER PROTECTION

In a number of countries, consumer protection legislation is separate from restrictive business practices legislation.

POSSIBLE ELEMENTS FOR ARTICLE 6

NOTIFICATION

I. Notification by enterprises

1. When practices fall within the scope of Articles 3 and 4 and are not prohibited outright, and hence the possibility exists for their authorization, enterprises could be required to notify the practices to the Administering Authority, providing full details as requested.

2. Notification could be made to the Administering Authority by all the parties concerned, or by one or more of the parties acting on behalf of the others, or by any persons properly authorized to act on their behalf.

3. It could be possible for a single agreement to be notified where an enterprise or person is party to restrictive agreements on the same terms with a number of different parties, provided that particulars are also given of all parties, or intended parties, to such agreements.;

4. Notification could be made to the Administering Authority where any agreement, arrangement or situation notified under the provisions of the law has been subject to change either in respect of its terms or in respect of the parties, or has been terminated (otherwise than by effluxion of time), or has been abandoned, or if there has been a substantial change in the situation (within ( ) days months of the event) (immediately).

5. Enterprises could be allowed to seek authorization for agreements or arrangements falling within the scope of Articles 3 and 4, and existing on the date of the coming into force of the law, with the proviso that they be notified within (days months) of such date.

6. The coming into force of agreements notified could depend upon the granting of authorization, or upon expiry of the time period set for such authorization, or provisionally upon notification.

7. All agreements or arrangements not notified could be made subject to the full sanctions of the law, rather than mere revision, if later discovered and deemed illegal.

II. Action by the Administering Authority

1. Decision by the Administering Authority (within ( ) days months of the receipt of full notification of all details), whether authorization is to be denied, granted or granted subject where appropriate to the fulfillment of conditions and obligations.

2. Periodical review procedure for authorizations granted every ( ) months years, with the possibility of extension, suspension, or the subjecting of an extension to the fulfillment of conditions and obligations.

3. The possibility of withdrawing an authorization could be provided, for instance, if it comes to the attention of the Administering Authority that:

(a) The circumstances justifying the granting of the authorization have ceased to exist;

(b) The enterprises have failed to meet the conditions and obligations stipulated for the granting of the authorization;

(c) Information provided in seeking the authorization was false or misleading.

POSSIBLE ELEMENTS FOR ARTICLE 7

THE ADMINISTERING AUTHORITY AND ITS ORGANIZATION

1. The establishment of the Administering Authority and its title.

2. Composition of the Authority, including its chairmanship and number of members, and the manner in which they are appointed, including the authority responsible for their appointment.

3. Qualifications of persons appointed.

4. The tenure of office of the chairman and members of the Authority, for a stated period, with or without the possibility of reappointment, and the manner of filling vacancies.

5. Removal of members of the Authority.

6. Possible immunity of members against prosecution or any claim relating to the performance of their duties or discharge of their functions.

7. The appointment of necessary staff.

POSSIBLE ELEMENTS FOR ARTICLE 8

FUNCTIONS AND POWERS OF THE ADMINISTERING AUTHORITY

I. The functions and powers of the Administering Authority could include (illustrative):

(a) Making inquiries and investigations, including as a result of receipt of complaints;

(b) Taking the necessary decisions, including the imposition of sanctions, or recommending same to a responsible minister;

(c) Undertaking studies, publishing reports and providing information to the public;

(d) Issuing forms and maintaining a register, or registers, for notifications;

(e) Making and issuing regulations;

(f) Assisting in the preparation, amending or review of legislation on restrictive business practices, or on related areas of regulation and competition policy;

(g) Promoting exchange of information with other States.

II. Confidentiality:

1. According information obtained from enterprises containing legitimate business secrets reasonable safeguards to protect its confidentiality.

2. Protecting the identity of persons who provide information to competition authorities and who need confidentiality to protect themselves against economic retaliation.

3. Protecting the deliberations of government in regard to current or still uncompleted matters.

POSSIBLE ELEMENTS FOR ARTICLE 9

SANCTIONS AND RELIEF

I. The imposition of sanctions, as appropriate, for:

(i) Violations of the law;

(ii) Failure to comply with decisions or orders of the Administering Authority, or of the appropriate judicial authority;

(iii) Failure to supply information or documents required within the time limits specified;

(iv) Furnishing any information, or making any statement, which the enterprise knows, or has any reason to believe, to be false or misleading in any material sense;

II. Sanctions could include:

(i) Fines (in proportion to the secrecy, gravity and clear-cut illegality of offences or in relation to the illicit gain achieved by the challenged activity);

(ii) Imprisonment (in cases of major violations involving flagrant and intentional breach of the law, or of an enforcement decree, by a natural person);

(iii) Interim orders or injunctions;

(iv) Permanent or long-term orders to cease and desist or to remedy a violation by positive conduct, public disclosure or apology, etc.;

(v) Divestiture (in regard to completed mergers or acquisitions), or rescission (in regard to certain mergers, acquisitions or restrictive contracts);

(vi) Restitution to injured consumers;

(vii) Treatment of the administrative or judicial finding of illegality as *prima facie* evidence of liability in all damage actions by injured persons.

POSSIBLE ELEMENTS FOR ARTICLE 10

APPEALS

1. Request for review by the Administering Authority of its decisions in light of changed circumstances.

2. Affording the possibility for any enterprise or individual to appeal within ( ) days to the (appropriate judicial authority) against the whole or any part of the decision of the Administering Authority, (or) on any substantive point of law.

POSSIBLE ELEMENTS FOR ARTICLE 11

ACTIONS FOR DAMAGES

To afford a person, or the State on behalf of the person who, or an enterprise which, suffers loss or damages by an act or omission of any enterprise or individual in contravention of the provisions of the law, to be entitled to recover the amount of the loss or damage (including costs and interest) by legal action before the appropriate judicial authorities.

PART II

COMMENTARY TO ARTICLES

COMMENTARY TO ARTICLE 1

OBJECTIVES OR PURPOSES OF THE LAW

8. This article has been framed in accordance with section E, paragraph 2, of the Set of Principles and Rules, which sets out the primary principle on which States should base their restrictive business practices legislation. As in section A of the Set of Principles and Rules, States may wish to indicate other specific objectives of the law, taking into account the impact of restrictive business practices on their trade and development.

9. The new text refers to "control", which is in the title of the Set of Principles and Rules, and to restrictive agreements and abuses of dominant positions of market power, which are the practices set out in sections C and D of the Set. The 1984 text implies that all RBPs must involve an abuse of a dominant position, but the Set makes it clear that price fixing, etc., is illegal regardless of whether there is an abuse or a dominant position.

COMMENTARY TO ARTICLE 2

DEFINITIONS AND SCOPE OF APPLICATION

10. The definitions have been expanded to include one of "relevant market". The approach of the definition is that developed in United States merger guidelines, but generally accepted by most antitrust economists in most countries. [For a detailed explanation of the concept of "relevant market", see paragraph 58, page 26, of "Elements for provisions of a model law", document TD/B/RBP/15/Rev.1.]

11. The scope of application has been expanded to clarify the application of the law to natural persons, but not to governmental officials acting for a Government. However, a natural person is not an "enterprise", unless incorporated as a "personal corporation". The model law could imply that an agreement between a company and its own managing director is an agreement between two "enterprises" and thus a conspiracy. Legal analysis nearly everywhere concludes that this should not be the case.

12. Although virtually all international restrictive business practice codes, such as the EFTA Antitrust Code, the Caribbean Basis Antitrust Code, and the EC Treaty (Articles 85 and 86), apply only to enterprises, most national RBP laws apply to natural persons as well as enterprises, since deterrence and relief can be made more effective at the national level if owners or executives of enterprises can be held personally responsible for the violations they engage in or authorize.

13. Further, this definition makes clear that any agreement or action of an enterprise (except an agreement with the state) can be scrutinized to determine whether it contains an unacceptable restriction or constitutes an abuse of a dominant position.

14. The scope of application has also been clarified to exclude the sovereign acts of local Governments, to whom the power to regulate has been delegated, and to protect the acts of private persons when their conduct is compelled or supervised by Governments.

15. The reference to intellectual property is consistent with virtually all antitrust laws, which treat licenses of technology as "agreements" and scrutinize them for restrictions or abuses like any other agreements, except that the legal exclusivity granted by the state to inventors may justify some restrictions that would not be acceptable in other contexts.

COMMENTARY TO ARTICLE 3

RESTRICTIVE AGREEMENTS OR ARRANGEMENTS

16. This article has been amended to clarify when denial of access to a joint venture should be prohibited.

17. A number of jurisdictions have ruled that firms under common ownership or control are not rival or potentially rival firms (see, e.g., *Centrafarm B.V. v. Sterling Drug*, 1974 ECR 1147 (EC); *Copperweld Corp. v. Independence Tube Corp.*, 104 S. Ct. 2731 (1984)).

18. The reference to "public benefit" is a short form of the standard used, for instance, in Article 85(3) of the EC Treaty.

1. Prohibition of restrictive agreements or arrangements

19. The elements of this Article are based upon section D, paragraph 3, of the Set of Principles and Rules and in this paragraph a prohibition in principle approach has generally been followed. Such an approach is embodied, or appears to be evolving, in the restrictive practice laws described below.

20. Recent enforcement attitudes toward naked, secret cartel arrangements have been to seek deterrence by means of very substantial fines for companies, and in the United States, substantial jail sentences for responsible individuals. In the EC, members of a plastics (PVC) cartel were fined more than 30 million ECUs ($32 million) under a regulation allowing the EC Commission to assess fines of up to 10 per cent of the annual turnover of the offending enterprises (*Hoechst AV v. Commission*, Case 46/87R 1987 E. Comm. J. Rep. 1549 (1988)). In the United States, legislation was enacted in 1990 raising the maximum corporate fine for an antitrust violation from $1 million to $10 million (H.R. 29, Antitrust Amendment Act of 1990). In Japan, legislation has been introduced to allow fines of up to 6 per cent of the total commerce affected over a three-year period. A world record fine of $80 million was imposed by the Japanese Fair Trade Commission (JFTC) on a cement cartel in 1991 (60 BNA ATRR 459).

21. In the United Kingdom, the Government review of competition policy, which began in 1986, has resulted in the issuance of a Green Paper, entitled "Review of Restrictive Trade Practices Policy", which proposes a complete overhaul of the more than 30-year old legislation on restrictive business practices. The document recommends new legislation which would prohibit all agreements between enterprises which produce anticompetitive effects, similar to the prohibition contained in Article 85 (1) of the EEC Treaty of Rome, as follows: "All agreements and concerted practices between undertakings, and decisions and recommendations by associations of undertakings which have the object or effect of preventing or restricting or distorting competition, in the United Kingdom, or in any part of it". Within this general prohibition, the law would enumerate the following "hard-core" anticompetitive agreements and concerted practices:

(i) Those fixing prices and charges, including any terms or conditions (e.g. discounts, credit terms) which determine effective net prices (recommendations by trade, professional and other associations on prices or charges are also included if those recommendations have the effect of determining minimum or actual prices);

(ii) Collusive tendering;

(iii) Those sharing or allocating markets, customers, raw materials or other inputs, production or capacity;

(iv) Those prohibiting or otherwise restricting advertising or the provision of other promotional information;

(v) Collective refusals to supply or to deal with suppliers, collective discrimination in the terms on which different customers or classes of customer are supplied, and collective anti-competitive conditions of supply such as tie-ins, aggregated or loyalty rebates and "no competition" clauses.

22. In India, the recommendations of the Sachar Committee culminated in the Monopolies and Restrictive Trade Practices (Amendment) Act of 1982 and 1984 which, in Section 32, introduced a presumption that monopolistic trade practices were prejudicial to the public interest and were therefore prohibited, subject to the defences stipulated in the Act.

(a) Agreements or arrangements between enterprises dealing with each other in the context of an economic entity wherein they are under common control

23. In the United States, the rule of the *Copperweld* decision, that commonly owned enterprises cannot be treated as rivals or separate actors, has been extended by later decisions to include companies which are majority-owned by another firm. (For example, *Satellite Fin. Planning Corp. v. First National Bank*, 633 F. Supp. 386 (D.Del.1986), but see *Sonitrol of Fresno v. AT&T*, 1986-1 Trade Cas. (CCH) § 67,080 (32.6 per cent ownership does not establish lack of rivalry).)

(b) Enterprises must be engaged on the market in rival or potentially rival activities

(c) Formal, informal, written or unwritten agreements or arrangements

(d) Limit access to markets or otherwise unduly restrain competition having or likely to have adverse effects on trade or economic development

II. Illustrative list of practices

(a) Agreements fixing prices, including as to exports and imports

24. In the Republic of Korea, after the United States limited the import of colour television sets from the Republic of Korea, Samsung, Gold Star and Dae Woo cut prices locally to increase sales, but then agreed with each other to cease cutting prices. The Fair Trade Office ordered an end to the price fixing and required the companies to apologize in the local newspaper, which they did (in re *Samsung Electronics Company*, 4 KFTC 58 (Dec.26, 1984)).

(b) Collusive tendering

25. The 1988 Restrictive Trade Practices, Monopolies and Price Control Act of Kenya makes it a criminal offence punishable by up to three years' imprisonment for two or more persons to tender for the supply or purchase of goods or services at a price, or on terms, agreed or arranged between them, except for joint tenders disclosed to, and acceptable to, the persons inviting the tender.

26. In Sweden, the Competition Act of 1983 makes collusive tendering a criminal offence. However, exemptions may be granted under certain conditions.

(c) Market or customer allocation arrangements

(d) Allocation by quota as to sales and production

(e) Collective action to enforce arrangements, for example by concerted refusals to deal

27. In June 1991, a United States Court of Appeals held that London reinsurers could be tried for an illegal boycott when such reinsurers agreed not to deal with any United States insurance companies which offered insurance covering accidents not discovered and claimed on while the policies were in effect, and thus forced adoption of uniform "claims made" policies throughout the United States (in re *Insurance Antitrust Litigation*, Dkt. 89-1653O, reported in 60 BNA ATRR 909 (6/27/91)).

(f) Concerted refusal of supplies to potential buyers

(g) Collective denial of access to an arrangement or association which is crucial to competition

28. This rule has been clarified in the United States by holdings that a buying group with less than 30 per cent of the market can exclude firms as it wishes (*Northwest Wholesale Stationers v. Stationery & Printing Co.* 472 U.S. 284 (1985)), and that valid professional concerns can justify exclusions of individuals from professional associations (*Wilk v. American Medical Assoc.*, 1987 - 2 CCH Trade Cas. §67,721 (N.D.Ill.1987)).

III. Authorization of practices not prohibited outright

29. In India, the Monopolies and Restrictive Trade Practices (Amendment) Act, section 32, presumes that monopolistic trade practices are prejudicial to the public interest and are therefore prohibited, subject only to the defences of authorization by law, defence and security, supply of goods and services essential to the community, and agreements entered into by the Government.

30. In the United Kingdom, the Green Paper entitled "Review of Restrictive Trade Practices Policy" proposes that the registration system be abolished, as it would be illegal for businesses to operate any agreement which restricts, distorts or prevents competition. However, the law would allow exemptions to be granted on a case-by-case basis or under a block exemption. The exemption test proposed is along the lines of Article 85 (3) of the Treaty of Rome. The exemption would be granted if it:

(i) Contributes to improving the production or distribution of goods, or promotes technical or economic progress;

(ii) Allows consumers a fair share of the resulting benefits;

(iii) Does not entail restrictions which go beyond what is indispensable to attain those objectives;

(iv) Does not allow competition to be eliminated.

31. Among the possible agreements to be granted block exemptions are: exclusive distribution and purchasing agreements, patent licensing, intellectual property and know-how agreements, research and development agreements, and franchising agreements.

COMMENTARY TO ARTICLE 4

ACTS OR BEHAVIOUR IN AN ABUSE, OR ACQUISITION AND ABUSE, OF A DOMINANT POSITION OF MARKET POWER

32. Article 4 (II) (f) has been amended to set forth the usual standard for antitrust concern about a merger or acquisition.

I. Prohibition on acts or behaviour involving an abuse, or acquisition and abuse, of a dominant position of market power

1. The relevant market

(a) Product market (references to products include services)

(b) Geographic market

2. An enterprise, either by itself, or acting together with a few other enterprises, is in a position to control the relevant market for a particular good or service, or groups of goods or services, i.e. a dominant position of market power

(a) Dominant position of market power

33. In Poland, the Law of 24 February 1990 on Counteracting Monopolistic Practices provides a presumption that a firm with more than 30 per cent of sales in a market is in a dominant position. The same presumption is contained in Article 9 of the 1991 Competition Protection Law in Czechoslovakia.

(b) Abuse, or acquisition and abuse, of a dominant position

34. In Germany, in 1989, the Federal Cartel Office held that it was an abuse of dominant position of market power for gas supply companies immediately to pass on to distributors the full cost of a tax increase on the price of natural gas (Eighth Biennial Report of the Monopolies Commission. No.127, p.443 (1989)).

35. In the United States, both the Department of Justice and the Federal Trade Commission employ a careful enforcement approach to single firm behaviour and changes in industry structure, intervening only in those instances in which mergers, joint ventures, distribution arrangements, licensing, or other types of single firm behaviour threaten to produce clear and substantial anti-competitive effects. In Australia, the most significant amendments to the Trade Practices Act in 1986 were designed to improve the effectiveness of the provisions dealing with misuse of market power (section 46) and the application of merger provisions (section 50). Section 46 as previously drafted proved to be of limited effectiveness in controlling misuse of market power, principally because the section applied only to monopolists or those with overwhelming market dominance. Even in those cases, it was extremely difficult to prove the requisite predatory purpose. The amendments to section 46 were designed to overcome these two problems. First, the threshold test for the application of section 46 is now reduced from that of a corporation "being in a position subsequently to control a market" to "a corporation that has a substantial degree of market power". By lowering the threshold, the section may now be invoked in relation to a corporation that has a lesser degree of market power than was previously the case. The amended section is not directed at size as such, but rather at the misuse by a corporation of its market power. To reflect this, the description of the section has been changed from "monopolization" to "misuse of market power". New sub-section 46 (3) provides a guide to the way in which "market power" is to be determined. It requires that consideration be given to the extent to which the conduct of a firm is or is not constrained by competition on the part of other participants in the market, potential entrants to the market, suppliers or purchasers. Secondly, new sub-section 46 (7) makes it clear that a Court can infer the requisite predatory purpose from the conduct of the corporation or from the surrounding circumstances. While proven explicit statements may establish the necessary purpose, direct evidence of that kind is not essential. The section is directed at conduct having a predatory purpose, not at competitive behaviour as such. Such conduct may include inducing price discrimination, refusal to supply and predatory pricing. These instances are indicative only and, in each case, it would be necessary to establish the requisite degree of market power and that advantage had been taken of that power for one of the specified predatory purposes.

36. Amendments to section 50 were designed to clarify the application of the provision, and to remove uncertainties that have become apparent in the operation of the provision. The section prohibits mergers which will result in a corporation being able to control or dominate a market, except where prior authorization is obtained, on public benefit grounds, from the Trade Practices Commission. The prohibition is directed at joint venture acquisitions and acquisitions by natural persons. Where a corporation is in a position to exert a substantial degree of influence over the activities of another corporation, the latter will be taken to be associated with the former. Thus, for the purposes of determining whether an acquirer is in a position to dominate a market, the market position of any "associated" corporation will be aggregated with the position of the acquirer.

II. Abusive acts or behaviour

(a) Predatory behaviour towards competitors, such as using below-cost pricing to eliminate competitors

(b) Discriminatory pricing, or terms or conditions in the supply or purchase of goods, including through transfer pricing

(1) Discriminatory pricing

(2) Non-price discrimination

(c) Fixing the prices at which goods sold can be resold, including those imported and exported

37. Under the Swedish Competition Act, 1983, resale price maintenance is a criminal offence, although exemptions may be granted under certain conditions. In Portugal, the Competition Law, which came into force in June 1984, prohibits all minimum resale price maintenance, except as to books and periodicals (Decree-Law No.422/83, discussed in UNCTAD, TD/B/RBP/49 (1988)).

(d) Use of trademarks to prevent importation of identical or similar products legitimately bearing the identical or similar mark

38. In *K. Mart Corp. v. Cartier, Inc.*,, 486 U.S.281 (1987), the United States Supreme Court, in a 5-to-4 vote, legitimized the so-called "gray market" discounters' practice of giving customers bargain-priced goods. The court upheld Customs Service rules that let such stores as K mart Corp. and 47th Street Photo Inc. buy cameras, perfume, and other consumer producers overseas and sell them in the United States without the permission of the American trademark owners. However, the ruling involved no direct issue of antitrust law.

OTHER RESTRICTIONS ON THE PURCHASE, MANUFACTURE AND SALE OF GOODS
(Article 4, II (e), (i) to (iv))

(e) When not for ensuring the achievement of legitimate business purposes, such as quality, safety, adequate distribution or services

(i) Partial or complete refusals to deal on the enterprise's customary commercial terms

39. In 1989 in Germany the Federal Cartel Office held that it was abusive for the dominant, regulated airline, Lufthansa, to refuse to interline with a small rival, since such agreements were customary and the purpose of the refusal appeared to be anti-competitive (Eighth Biennial Report of Monopolies Commission, No.128, p.443 (1989)).

40. In France, Ordinance No. 86 - 1243 on Price Liberalisation and Competition (1 December 1986) prohibits the abuse of a dominant position of market power by one or more enterprises either on a given market, on a substantial part of such a market, or on suppliers or purchasers who are economically dependent. Such abuse includes: refusals to sell, tied sales, price discrimination, conditions of supply (for example when a dealer refuses to submit to unjustified commercial conditions).

(ii) Making the supply of particular goods or services dependent upon the acceptance of restrictions on the distribution or manufacture of competing or other goods

41. In 1988, an Israeli court fined the Koor Company NIS 25,000 and six steel merchants NIS 20,000 each after finding that they had engaged in an illegal arrangement under which the merchants agreed to buy only steel produced by Koor. The court further warned the parties that a repeat offense would cost them NIS 4,000 and NIS 10,000 respectively (see "Investing Licensing & Trading", *Business International*, January 1989.

(iii) Imposing restrictions concerning where, or to whom, or in what form or quantities, goods supplied or other goods may be resold or exported

(1) Territorial allocations

(2) Customer allocation

(iv) Making the supply of particular goods or services dependent upon the purchase of other goods or services from the supplier or his designee

42. The United States amended its patent law in 1988 to provide that tying one patent to another, or to purchase of a separate product, will not constitute an illegal extension of the patent right unless "the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned" (H.R. 4972, amending Section 271(d) of the Patent Act). This legislative action effectively overruled previous statements by United States courts that the holder of a patent should be presumed to have market power. The United States Congress accepted that many patented products are subject to effective competition from substitute products.

43. More recently, United States case law appears to have shifted generally towards more favourable evaluation of vertical restraints in general and of tied purchasing practices in particular. Officials of the United States Department of Justice indicate that:

> "By and large, (...) vertical restraints perform legitimate economic functions. We therefore oppose per se illegality of any vertical restraint, including tie-ins and resale price maintenance. Faced with an extreme choice of prohibiting or permitting vertical restraints in all circumstances, we would opt for the latter." *(Information supplied by the Government.)*

44. The Supreme Court ruled that producers do not necessarily violate antitrust laws if they cut off bargain outlets after getting complaints from full-price retailers.

45. In 1985, the Anti-trust Division of the Department of Justice issued guidelines describing its enforcement policy in respect of vertical restraints: the Division would not take legal proceedings against the use of vertical practices by firms with less than a 10 per cent market share. And vertical practices by firms with larger than 10 per cent market share would not necessarily be subject to challenge but would be subject to further analysis under the rule of reason.

(f) Mergers, takeovers, joint ventures, or other acquisition of control, including interlocking directorates, whether of a horizontal, vertical or a conglomerate nature

46. In December, 1989, the European Communities adopted their first comprehensive system of merger control, which became effective in September, 1990. The new regulation requires the registration of all mergers or acquisitions between firms with a combined turnover of five billion ECUs, each having at least 200 million of turnover in the EC. Such transactions have to be notified, and halted for up to 90 days if investigated. In 1990 and 1991 the Commission fully investigated more than a dozen transactions, and caused the modification of some which it believed could violate the regulatory standard by creating or strengthening a dominant position of market power

in the common market or a substantial part of it and impeding the maintenance or development of effective competition in the relevant market. The Commission is authorized to lower the size thresholds by 1991 (see Davidow, "Competition Policy, Merger Control and the European Community's 1992 Program," 29 Colum. *Journal of Transnational Law*, No.11 (1991)).

47. In Germany, the Federal Cartel Office prohibited the acquisition of a major importing firm by a leading local producer, which would have given the producer control of low priced cement imports from Eastern Europe and allowed the resulting firm to dominate the South German market (Eighth Biennial Report of the German Monopolies Commission, 1989, No.147-148, p.446).

(1) Horizontal acquisitions of control

48. The Korean Fair Trade Office held illegal an acquisition combining a company with 54 per cent of the PVC stabilizer market and another company with 19 per cent of the market. The acquiring company was ordered to dispose of the stock (in re *Dong Yang Chemical Industrial Co., 1 KFTC 153* (Jan. 13, 1982)).

(2) Vertical acquisitions of control

49. In *Alberta Gas Chems. Ltd. v. E.I. DuPont de Nemours & Co., 826 F.2d 1235 (3d Cir. 1987)*, the court noted that "respected scholars question the anticompetitive effects of vertical mergers in general" and held that an acquisition causing a one per cent foreclosure was too minor to raise any legal question.

(3) Conglomerate acquisitions of control

(4) Cross-frontier acquisitions of control

50. In India in 1989, the Monopolies Commission allowed Timken to acquire a 40 per cent stake in a joint venture with Tata Iron and Steel Ltd. because it found the venture would have superior technology but would still face substantial competition and thus not be dominant (see "Business Asia" reports, *Business International*, 14 September 1989).

51. In Australia, amending legislation to strengthen and improve the effectiveness of the Trade Practices Act, 1986, was introduced to cover overseas mergers of foreign corporations with subsidiaries in Australia. Subsection 50A (1) provides that the Tribunal may, on the application of the Minister, the Commission or any other person, make a declaration that a person who, as a consequence of an acquisition outside Australia, obtains a controlling interest (defined by subsection 50A (8)) in one or more corporations, would or would be likely to dominate a substantial market for goods or services in Australia, and that the acquisition will not result in a public benefit. The term "substantial market for goods and services" is used to make it clear that the provision applies only to markets of a similar magnitude to those to which section 50 applies.

(5) Interlocking directorates

52. In the United States, the law was expanded in 1990 to provide that it is illegal not only for a company to have one of its directors serve also as a director of a competitor, but also for it to have one of its corporate officers serve as a director of a competitor (see the Amendments Act of 1990).

COMMENTARY TO ARTICLE 5

SOME POSSIBLE ASPECTS OF CONSUMER PROTECTION

53. In India, following the recommendations of the Sachar Committee, and the consequent amendment of the MRTP Act of 1982, one of the significant provisions introduced in the Act was consumer protection. A very important new provision on unfair trade practices for which there was no specific provision previously was incorporated, covering misleading advertisement, bargain selling, hoarding, destruction of goods, etc.

54. In Australia, one of the significant amendments in 1986 to the Trade Practices Act was part V of the Act, concerning consumer protection. The new section 52A prohibits, on a civil basis, unconscionable conduct by corporations in relation to consumer-type transactions. Where a contravention is proved, remedies under section 87 will be available, and the Trade Practices Commission will enforce the section by seeking injunctions where appropriate. The section is directed at conduct which, while it may not be misleading or deceptive, is nevertheless clearly unfair or unreasonable. For example, a corporation which attempted to take advantage of a buyer's obvious lack of understanding of a transaction might fall foul of this section. The new provisions will supplement existing provisions of part V and strengthen the protection afforded to consumers against unscrupulous trading practices.

55. The amendments also strengthen provisions enabling bans to be placed on the supply of unsafe products. In the previous Act, such provisions could not be applied to unsafe products supplied before a banning order was issued. Many industries have established voluntary procedures for the recall of unsafe products in the marketplace. However, to provide an adequate mechanism for remedial action across the range of potentially unsafe products, the Government considered it necessary to provide mandatory recall powers which can be used when necessary. Where no voluntary procedures exist, or the procedures are inadequate, these powers will be able to be exercised to ensure that unsafe products are recalled from circulation or that other remedial action is taken. The provisions for mandatory recall are designed to provide reserve powers which will be available for use where the safety of the public is threatened and the situation cannot be handled adequately by voluntary recall schemes or other means. In all cases, primary responsibility for ensuring the safety of consumer goods remains with manufacturers and importers.

56. In Canada, one of the objectives of the new Competition Act, 1986, is protection of consumers. Similarly, in Sri Lanka, the new Fair Trading Commission Act No.1 of 1987 provides that the Fair Trading Commission, in examining matters pertaining to prices, should have special regard to the interests of consumers. The new Act strengthens the Consumer Protection Act No.1 of 1979.

COMMENTARY TO ARTICLE 6

NOTIFICATION

COMMENTARY TO ARTICLE 7

THE ADMINISTERING AUTHORITY AND ITS ORGANIZATION

57. In Peru, a 1991 law creates a commission of six members from four governmental ministries. In Kenya, the Restrictive Trade Practices, Monopolies and Price Control Act of 1988 establishes a Monopolies and Prices Commissioner and such other officers as may be necessary for the administration of the Act.

58. In the United Kingdom, the Green Paper entitled "Review of Restrictive Trade Practices Policy" proposes that a competition authority be established, based on the present Office of Fair Trading but with a new structure and operations. In France, the new Competition Law (Ordinance No.86-1243 of 1 December 1986), under title II, established a new Competition Council (Conseil de la Concurrence) composed of 16 members nominated for six years (and renewable). Similarly, in Canada, the new Competition Act, 1986, established a Competition Tribunal and abolished the Restrictive Trade Practices Commission.

59. In Sri Lanka, the Fair Trade Commission Act (No.1 of 1987), which repealed the National Price Commission Law, 1975, established a Fair Trade Commission to discharge the functions previously undertaken by the Price Commission to control monopolies, mergers and anti-competitive practices and to formulate and implement a national price policy. The Act provides that no civil or criminal proceedings shall be instituted against the Commission for any act which in good faith is done or purported to be done by the Commission under this Act, or against any member, officer, servant or adviser of the Commission for any act which in good faith is done or purported to be done by him under this Act.

COMMENTARY TO ARTICLE 8

FUNCTIONS AND POWERS OF THE ADMINISTERING AUTHORITY

60. The previous text has been expanded to emphasize the use of RBP control authorities to comment on issues of regulation and competition and to engage in cooperation with similar authorities in other countries.

61. The confidentiality section has been expanded to mention the usual practice of protecting informers and the decisional deliberations of authorities.

62. In the United Kingdom, the Green Paper entitled "Review of Restrictive Trade Practices Policy", 1986, proposes the creation of a Competition Authority with stronger enforcement powers. The authority would have powers to require the production of information and documentation, in addition to powers of entry and search. The authority would also have power to levy fines up to a maximum of 10 per cent of total turnover. In addition, it would be empowered to apply to the Restrictive Practices Court for cease and desist orders, the breach of which would constitute contempt and thus be subject to fines and or imprisonment. Failure to comply with a reasonable request for information, the supply of misleading or false information and the reckless or wilful suppression or destruction of information would be subject to penalties. Severe penalties for obstruction of an investigation by the authority would be imposed. The law would also provide the right of private actions as an added deterrent to the making of anti-competitive agreements.

63. In France, the Competition Council, which controls anti-competitive practices as well as mergers, must also be consulted with respect to regulative or legislative texts prepared by the Government. It can take decisions and will publish annual reports; it can open a case, or be asked to do so by the Minister of Economics, by enterprises, independant administrative authorities, professional organizations, unions, consumer associations, etc. It can impose penalties of up to 5 per cent of annual turnover or up to 5 million French francs. The law describes the investigatory process, which entitles defendants to take recourse in the Appeals Court of Paris.

COMMENTARY TO ARTICLE 9

SANCTIONS AND RELIEF

64. This section has been expanded to emphasize the varied nature of sanctions and relief measures which nations are now adopting, including break-up of monopolies, restitution of illicit profits, etc..

65. A United States commission dealing with punishment of corporate crime recommended, in 1990, that fines be determined in part in relation to the amount of commerce affected by the illegal scheme (see *United States Sentencing Commission Guidelines Manual*, November 1990).

COMMENTARY TO ARTICLE 10

APPEALS

66. The European Community has recently created a specialized Court of First Instance to hear antitrust appeals, since such cases had begun to be a burden on the European Court of Justice, due to the extensive factual records involved (discussed in *I-A Hawk, United States, Common Market and International Antitrust, 37,* (1990 ed.)).

67. In Kenya, in addition to the Administering Authority, i.e. the Monopolies and Prices Commissioner and other officers, the Restrictive Trade Practices, Monopolies and Price Control Act, 1988, established a Restrictive Trade Practices Tribunal consisting of a Chairman, who must be an advocate of not less than seven years' standing, and at least two members appointed by the Minister. The Tribunal hears appeals and has powers to confirm, modify or reverse the order appealed against.

COMMENTARY TO ARTICLE 11

PRIVATE ACTIONS FOR RELIEF OR DAMAGES

68. Brazil, by adopting Law 8158 on 10 January 1991, has authorized competitors or injured persons generally to sue to enjoin crimes against the economic order, including price-fixing, predatory pricing and tying (see *60 BNA ATRR 426 (1991)*).

69. In Australia, one of the significant amendments to the Trade Practices Act 1986 was Clause 55 which amended section 87 in order to enable the Trade Practices Commission to obtain redress on behalf of particular named persons who have suffered loss or damage because of the conduct of a corporation or person in breach of the consumer protection provisions in division 1 or 1A of Part V. One of the main obstacles preventing consumers from enforcing their rights under the Act is the high cost of litigation. By allowing the Commission to seek compensation on behalf of particular consumers in certain circumstances, consumers will more easily gain redress. The amendment will be particularly useful where the Commission takes enforcement action in situations such as where a large number of consumers have each been defrauded of relatively small amounts, or where a small group of consumers have lost their savings as a result of a fraudulent representation. This kind of proceeding will be a representative action rather than a so-called "class action". The question of remedies for aggrieved consumers will only arise once the Commission has established a contravention of part V in a prosecution or a proceeding for an injunction. The aggrieved consumers must be identified in the application and must have consented in writing to the Commission's acting on their behalf. The Court is not empowered to award damages to a class of persons, but only to particular named persons. The amount of the loss suffered by each individual by reason of the contravention will have to be established.